



DEPARTMENT OF LABOR

Employee Benefits Security Administration

29 CFR Part 2550

[Application No. D-12007]

Z-RIN 1210-ZA35

Proposed Safe Harbor Class Exemption For Initial Acquisition of Employer Common Stock by ESOPs from Selling Shareholders

AGENCY: Employee Benefits Security Administration, U.S. Department of Labor.

ACTION: Notice of proposed class exemption.

SUMMARY: This document gives notice of a proposed class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974, as amended (ERISA or the Act), and the Internal Revenue Code of 1986, as amended (the Code). The prohibited transaction provisions at issue prohibit fiduciaries with respect to an employee stock ownership plan (ESOP) from causing the ESOP to purchase an asset from certain related parties, including officers, directors, and 10 percent or more shareholders of the employing company. This proposed exemption would provide relief from these provisions to the following parties involved in an ESOP's initial acquisition of non-publicly traded employer common stock from a Selling Shareholder: selling shareholders (the Selling Shareholders), any trustee that is independent of the Employer and represents the interests of the ESOP in the transaction (Independent Trustee), any appraiser that is independent of the Employer and represents the interests of the ESOP in the transaction (Independent Appraiser), and any fiduciary of the ESOP with authority to hire, monitor, or fire the Independent Trustee (Monitoring Fiduciary). The proposed exemptive relief provided herein is subject to protective conditions that are

designed to ensure that any transaction relying on the exemption is prudent and based on a reliable appraisal of the stock's fair market value.

DATES: *Comments due:* Written comments and requests for a public hearing on the proposed class exemption must be submitted to the Department by [INSERT DATE 75 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*].

Applicability date: The Department proposes that the exemption would be in effect for transactions that occur 60 days after the date the Department publishes a notice of final exemption in the *Federal Register*.

ADDRESSES: All written comments and requests for a hearing concerning the proposed class exemption should be sent to the Office of Exemption Determinations through the Federal eRulemaking Portal and identified by Application No. D-12007:

Federal eRulemaking Portal: <https://www.regulations.gov>. Follow the instructions for submitting comments.

Docket: For access to the docket to read background documents or comments, including the plain-language summary of the proposal required by the Providing Accountability Through Transparency Act of 2023, please go to the Federal eRulemaking Portal at <https://www.regulations.gov>.

See SUPPLEMENTARY INFORMATION below for additional information regarding comments.

FOR FURTHER INFORMATION CONTACT: Joseph Brennan, telephone (202) 693-8540 (this is not a toll-free number), Office of Exemption Determinations, Employee Benefits Security Administration, U.S. Department of Labor.

SUPPLEMENTARY INFORMATION:

Comment Instructions

Warning: All comments received will be included in the public record without change and will be made available online at <https://www.regulations.gov>, including any

personal information provided, unless the comment includes information claimed to be confidential or other information whose disclosure is restricted by statute. If you submit a comment, the Employee Benefits Security Administration (EBSA) recommends that you include your name and other contact information, but DO NOT submit information that you consider to be confidential, or otherwise protected (such as a Social Security number or an unlisted phone number), or confidential business information that you do not want publicly disclosed. However, if EBSA cannot read your comment due to technical difficulties and cannot contact you for clarification, EBSA might not be able to consider your comment. Additionally, the <https://www.regulations.gov> website is an “anonymous access” system, which means EBSA will not know your identity or contact information unless you provide it.

The Department is proposing this class exemption on its own motion, pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with the Department’s exemption procedures set forth in 29 CFR part 2570 (89 FR 4662 (Jan. 24, 2024)).¹

BACKGROUND

As described in more detail elsewhere in this issue of the *Federal Register*, an ESOP is a tax-qualified retirement plan designed to invest primarily in qualifying employer securities of the company employing the ESOP’s participants.² ESOPs

¹ Effective December 31, 1978, section 102 of Reorganization Plan No. 4 of 1978, 5 U.S.C. App. (2018), transferred the authority of the Secretary of the Treasury to issue exemptions of the type proposed in this notice to the Secretary of Labor.

² ERISA section 407(d)(6), 29 U.S.C. 1107(d)(6). ERISA section 407(d)(6) defines an “employee stock ownership plan” to be an individual account plan: (A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase plan both of which are qualified under section 401 of the Code, and which is designed to invest primarily in qualifying employer securities; and (B) which meets such other requirements as the Secretary of Treasury may prescribe by regulation under Code section 4975(e)(7). Section 4975(e)(7) defines an “employee stock ownership plan” as a defined contribution plan: (A) which is a stock bonus plan which is qualified, or a stock bonus plan and money purchase plan both of which are qualified under Code section 401(a) and which are designed to invest primarily in qualifying employer securities; and (B) which is otherwise defined in regulations prescribed by the Secretary of the Treasury. Treasury Regulation section 54.4975-11(b), which defines ESOP requirements, provides that a plan constitutes an ESOP only if the plan specifically states that it is designed to invest primarily in qualifying employer securities.

potentially offer benefits for both ESOP participants and employers. With regard to ESOP participants, ESOPs can offer employees a direct financial stake in their employer's growth often fostering a greater sense of personal attachment to their employer's success.³ With regard to employers, ESOPs "afford[] employers an innovative method of corporate capital financing"⁴ and may also promote productivity and profitability for the employer that sponsors the ESOP.⁵

The Department is proposing this exemption to provide a safe harbor for newly created ESOPs that are making their initial purchase of non-publicly traded common stock from Selling Shareholders in compliance with ERISA's fiduciary provisions. The Department's objective in proposing this exemption is to promote ESOP transactions that comply with ERISA, protect the interests of plan participants and beneficiaries in paying no more than fair market value for stock, and provide clarity to the parties so they can have confidence in the legality of the transactions covered. Under the terms of the exemption, sellers, in particular, can enter into ESOP transactions with greater certainty about their compliance with the law based on certifications from the responsible fiduciaries and appraiser. Although the exemption's terms are limited to straightforward common stock purchases, its terms reflect the application of basic fiduciary principles to the valuation and purchase of stock that is not publicly traded. For that reason, the exemption also effectively provides important guideposts for fiduciaries considering other stock transactions that are not covered by this proposed exemption, but that involve many of the same issues addressed here. The Department requests comment on the proposed conditions for this safe harbor.

³ Employee Stock Ownership Trusts: Tax Advantages for Estate Planning in Close Corporations, 84 Yale L.J. 1519 (1975). ESOPs "expand the ownership of income-producing capital, helping to avoid increased concentration of wealth, and they benefit employees by furnishing them with a valuable second income source in addition to wages." *Id.*

⁴ U.S. Gov't Accountability Office (GAO), *Employer Stock Ownership Plans: Who Benefits Most in Closely Held Companies?* (1980), at 1, <https://www.gao.gov/assets/hrd-80-88.pdf>.

⁵ See GAO, *Employee Stock Ownership Plans: Benefits and Costs of ESOP Tax Incentives for Broadening Stock Ownership* (1986), at 4, <https://www.gao.gov/assets/pemd-87-8.pdf> [hereafter 1987 GAO Report].

EBSA’s ESOP Investigations and Trustee Process Agreements

The Department regularly investigates ESOP transactions to evaluate whether the parties engaging in the transactions have complied with ERISA’s fiduciary standards and prohibited transaction rules. Since 2005, the Department has maintained an ESOP National Enforcement Project, the purpose of which is to identify and correct violations of ERISA in connection with ESOPs and ESOP transactions.⁶ A recurring theme in the Department’s investigations has been independent trustees’ improper reliance on unreliable valuations. As a result, the Department has insisted on obtaining “trustee process agreements” as part of the settlements of some of these ESOP cases. These agreements established procedures the trustees must follow to ensure the independence of trustees and appraisers, that relevant financial information is carefully reviewed, and that employer stock valuations are accurate and rely on appropriate professional standards. The Department has posted some of the trustee process agreements on EBSA’s website,⁷ and has directed the attention of the regulated community to the requirements of these process agreements, which provide a protective framework for independent trustees to comply with ERISA’s obligations in connection with transactions involving ESOPs.⁸ The proposed exemption reflects the principles and conditions set forth in the trustee process agreements.

⁶ U.S. Dep’t of Labor, EBSA, *Enforcement*, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement> (last visited September 19, 2023).

⁷ Employee Benefits Security Administration website, <https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/enforcement> (under the heading “National Enforcement Projects”).

⁸ *E.g.*, U.S. Dep’t of Labor, EBSA News Release, *US Labor Department Reaches \$5.25M Settlement with GreatBanc Trust* (June 30, 2014) (statement by then-Assistant Secretary of Labor for the Employee Benefits Security Administration that “[o]thers in the industry would do well to take notice of the protections put in place by th[e] [2014 process] agreement” between the Department and GreatBanc), <https://www.dol.gov/newsroom/releases/ebsa/ebsa20141043>; Frank Brown, *Q&A with Tim Hauser of the U.S. Department of Labor*, Willamette Mgmt. Assocs., *INSIGHTS 77-78* (Spring 2015) (statement by senior EBSA official that ESOP “transactions would be much better if people really took the provisions in th[e] [2014 process] agreement [with GreatBanc] to heart and followed them.”), <https://www.insights.willamette.com/assets/files/2015%20Spring%20-%20Corporate%20Transaction%20Financial%20Advisory%20Services.pdf>.

ERISA SECTION 408(e) STATUTORY EXEMPTION AND THE ADEQUATE CONSIDERATION DEFINITION

ERISA includes statutory exemptions that provide conditional relief from the Act's prohibited transaction restrictions.⁹ Several statutory exemptions rely on the term "adequate consideration" (as defined in ERISA section 3(18)) as a central condition relating to the amount paid or received by a plan.¹⁰ A fiduciary's determination of the adequacy of consideration paid under such circumstances represents a critical safeguard for plans against the potential for abuse inherent in such transactions, which commonly involve transactions between the plan and the plan sponsor's owners and managers. One such statutory exemption codified in ERISA section 408(e) provides conditional relief from the prohibited transaction restrictions for the acquisition or sale by certain plans of qualifying employer securities if, among other conditions, the acquisition, sale or lease is for "adequate consideration" as defined in ERISA section 3(18).¹¹

ERISA specifically authorizes the Department to promulgate an "adequate consideration" regulation.¹² Moreover, it "empowers the Secretary of Labor to 'prescribe such regulations as [the Secretary] finds necessary or appropriate to carry out' the

⁹ Congress also authorized the Department to grant conditional administrative exemptions from the prohibited transaction provisions, but only if the Department finds that the exemption is: (1) administratively feasible for the Department, (2) in the interests of the plan and of its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries of such plan. ERISA section 408(a), 29 U.S.C. 1108(a).

¹⁰ For instance, under section 408(b)(5) of the Act, a plan may purchase insurance contracts from certain parties in interest if, among other conditions, the plan pays no more than adequate consideration. 29 U.S.C. 1108(b)(5). Section 408(b)(7) of the Act provides that the prohibited transaction provisions of section 406 shall not apply to the exercise of a privilege to convert securities, to the extent provided in regulations of the Secretary, only if the plan receives no less than adequate consideration pursuant to such conversion. 29 U.S.C. 1108(b)(7). Additionally, section 414(c)(5) of the Act states that sections 406 and 407(a) of the Act shall not apply to the sale, exchange, or other disposition of property which is owned by a plan on June 30, 1974, and all times thereafter, to a party in interest, if such plan is required to dispose of the property in order to comply with the provisions of section 407(a), and if the plan receives not less than adequate consideration. 29 U.S.C. 1114(c)(5).

¹¹ ERISA section 408(e), 29 U.S.C. 1108(e); 29 CFR 2550.408e. Under 29 CFR 2550.408e(d)(1), adequate consideration in the case of a marketable obligation means a price not less favorable to the plan than the price determined under ERISA section 407(e)(1).

¹² ERISA sections 3(18)(B) and 505, 29 U.S.C. 1002, 1135.

statutory provisions securing employee benefit rights.”¹³ More recently, section 346(c)(4)(B) of SECURE 2.0¹⁴ requires that the Department issue formal guidance on the question of adequate consideration¹⁵ in the context of ESOP transactions.

In response to the Congressional directive in section 346(c)(4) of SECURE 2.0, the Department is proposing a regulation elsewhere in this edition of the *Federal Register* that would provide guidance on the definition of the term “adequate consideration” contained in section 3(18)(B) of ERISA for employer stock for which there is no generally recognized market.¹⁶ The proposed regulation would require *both* that the plan fiduciaries make a good faith determination of fair market value in accordance with their fiduciary obligations of prudence and loyalty, *and* that the price established for the stock transaction, in fact, accords with the asset’s fair market value.

In connection with the Department’s issuance of the proposed Adequate Consideration regulation, the Department also is proposing this class exemption as a safe harbor to provide the same relief ERISA section 408(e) provides for a specific covered transaction involving an ESOP’s initial acquisition of employer common stock directly from a Selling Shareholder. The Department proposes this exemption on its own motion in accordance with its authority in ERISA section 408(a). The proposed exemption’s conditions draw on the Department’s enforcement experience with respect to ESOP transactions, as well as on relevant case law and principles reflected in the trustee process agreements discussed above.¹⁷ An important objective in proposing this class exemption to encourage ESOP trustees to engage in transactions with Selling Shareholders by

¹³ *Black & Decker Disability Plan v. Nord*, 538 U.S. 822, 831 (2003) (quoting ERISA section 505, 29 U.S.C. 1135).

¹⁴ Codified at 29 U.S.C. 3228.

¹⁵ Technically, the subject legislation directs the Department to “issue formal guidance[] for . . . acceptable standards and procedures to establish *good faith fair market value*.” 29 U.S.C. 3228(c)(4) (italics added).

¹⁶ 29 CFR 2510.3-18(b).

¹⁷ See, e.g. *Perez v. Bruister*, 823 F.3d 250 (5th Cir. 2016); *Chao v. Hall Holding Co., Inc.*, 285 F.3d 415 (6th Cir. 2002); *Howard v. Shay*, 100 F.3d 1484 (9th Cir. 1996); *Donovan v. Cunningham*, 716 F.2d 1455 (5th Cir. 1983); *Su v. Bensen*, No. CV-19-03178-PHX-ROS, 2024 WL 3825058 (D. Ariz. Aug. 15, 2024).

following industry best practices as set forth in the Department's trustee process agreements to avoid a prohibited transaction and provide certainty to all parties involved in ESOP transactions that would be covered under the proposed exemption.

DESCRIPTION OF THE PROPOSED EXEMPTION

This administrative safe harbor class exemption would provide a detailed compliance roadmap for parties that choose to meet its conditions to avoid the liability and excise tax consequences associated with engaging in a prohibited transaction. As stated above, the proposed exemption only would provide relief for an ESOP's initial acquisition of the employer's common stock directly from a Selling Shareholder. The exemption does not address concerns that might arise when an ESOP that already owns employer stock purchases additional stock from a Selling Shareholder (e.g., concerns about the impact of any debt incurred to finance the new transaction on the value of any stock previously held by the ESOP). The exemption also only is available for the purchase of common stock directly from a Selling Shareholder. The exemption does not provide relief for transactions in which either the ESOP or other parties are granted or acquire other more complicated types of ownership interests such as preferred stock, convertible preferred securities, debt instruments, synthetic equity, warrants, or other types of ownership interests.

This proposed exemption would provide one path for ESOP fiduciaries to ensure they avoid engaging in a prohibited transaction when the ESOP makes its initial purchase of employer common stock from a Selling Shareholder. ESOP fiduciaries would not be required to comply with the proposed exemption provided that they comply with the statutory exemption in ERISA section 408(e), but complying with the proposed exemption would provide a safe harbor for the fiduciaries engaging in the Covered Transaction. The proposed exemption provides appropriate guardrails designed by the Department to ensure that the transaction is in the interest of ESOPs and their participants

and beneficiaries and protective of the rights of ESOP participants and beneficiaries. The proposed exemption would provide relief from ERISA section 406(a), (b)(1), and (b)(2) and the corresponding Code prohibitions to Selling Shareholders, Independent Trustees, Independent Appraisers, and any Monitoring Fiduciaries that are engaged in an initial transaction involving an ESOP's purchase of non-publicly traded Employer Stock from a Selling Shareholder (a "Covered Transaction"). This exemption would not cover any other type of transaction involving an ESOP's acquisition of Employer Stock, such as through a direct purchase from the Employer or in a transaction occurring in a public market.¹⁸

The proposed exemption's conditions would ensure that ESOPs and their participants and beneficiaries are not imperiled when ESOPs purchase non-publicly traded Employer Stock from Selling Shareholders. To accomplish this objective, the exemption would establish stringent standards for Covered Transactions that are discussed below. Under these standards, the sole responsibility for determining the appropriate purchase price for the Employer Stock would rest with the Independent Trustee. The Independent Trustee could rely on expert valuation advice it receives from the Independent Appraiser to fulfill this responsibility only if the Independent Trustee determines that the advice is sound, prudent, and loyal to the ESOP and its participants and beneficiaries. In this regard, the Independent Trustee would be required to:

- ensure that the Independent Appraiser adheres to appropriate professional standards;
- carefully review and understand the Independent Appraiser's valuation report;
- question the Independent Appraiser's methods and assumptions; and

¹⁸ The Department is proposing this new class exemption on its own motion pursuant to ERISA section 408(a) and Code section 4975(c)(2), and in accordance with procedures set forth in 29 CFR part 2570 et seq, Subpart B (89 FR 4662).

- appropriately resolve any concerns to reasonably justify its reliance on the Independent Appraiser's advice.

Parties to the Proposed Exemption

Relief under the proposed exemption would be limited to the following specific parties that are defined in section I of the proposed exemption.

Selling Shareholder

Proposed section I(j) defines the term "Selling Shareholder" to mean any individual or operating company that sells shares of Employer Stock directly to the ESOP as part of the Covered Transaction. For these purposes, an operating company is a company that is primarily engaged, either directly or through majority-owned subsidiaries, in the production or sale of a product or service other than the investment of capital.¹⁹ A Covered Transaction can involve multiple Selling Shareholders, and the exemption would provide relief for any Selling Shareholder who could otherwise face prohibited transaction liability or excise taxes from engaging in a non-exempt prohibited transaction with an ESOP. Under the exemption, a Selling Shareholder could be an employee or officer of the Employer that sponsors the ESOP.

Employer and Employer Stock

Proposed section I(c) defines the term "Employer" as a C corporation or an S corporation that is an operating company (as defined in 29 CFR 2510.3-101(c)) that sponsors the ESOP, and employs employees covered by the ESOP, and any company that is a member of the same controlled group of corporations as the employer (as defined in Code section 409(l)(4)). Therefore, to the extent the transaction involves stock of an affiliated company, the conditions of the proposed exemption that would apply to the Employer would also apply to the affiliated company.

¹⁹ See 29 CFR 2510.3-101(c).

Proposed section I(d) defines the term “Employer Stock” as common stock of the Employer. Employer Stock does not include other types of investments or securities, such as convertible preferred stock, debt securities, or synthetic equity. The Department defines Employer Stock with reference to Code section 409(l) based on Code section 4975(e)(8), which defines a qualifying employer security as “an employer security within the meaning of section 409(l).” For purposes of this proposed exemption, however, the Department would exclude convertible preferred stock, irrespective of whether it meets the terms of Code section 409(l)(3). As noted above, an ESOP is required to be designed to invest primarily in qualifying employer securities.²⁰ For securities that are not readily tradeable on an established securities market, Code section 409(l) generally includes common stock issued by the Employer having a combination of voting power and dividend rights equal to or in excess of the class of common stock of the Employer having the greatest voting power and the class of common stock of the Employer having the greatest dividend rights. While noncallable convertible preferred stock can be treated as an employer security in some circumstances under Code section 409(l), the proposed exemption would not provide relief for any securities other than common stock. In addition, under the terms of the exemption, the Independent Trustee must prudently ensure that any dividends on the stock are reasonably expected to be paid to the ESOP for ultimate allocation to participant accounts and not used to repay any debt incurred by the ESOP in connection with the Covered Transaction or to defray Employer contributions to the ESOP.²¹ This ensures that any anticipated dividend stream considered in connection with the valuation will be expected to benefit the plan and its participants.

The Department invites comment on the foregoing provisions. To the extent the Employer Stock definition is more restrictive than the definition of qualifying employer

²⁰ ERISA section 407(d)(6); Code section 4975(e)(7).

²¹ See section VI(h).

securities in ERISA section 407(d)(5), the Department specifically seeks comment on whether the exemption should be expanded to cover the broader ERISA definition and if so, what additional conditions would be necessary to ensure appropriate protection of plans and their participants and beneficiaries.

Monitoring Fiduciary

Proposed section I(i) defines the term “Monitoring Fiduciary” as a fiduciary with authority to select, monitor, and fire the Independent Trustee. The Monitoring Fiduciary could not be a Selling Shareholder or have a financial interest in the Covered Transaction and is liable if the ESOP enters into a non-exempt prohibited transaction.

The Department requests comment on the proposed definition of Monitoring Fiduciary, particularly the requirement that a Monitoring Fiduciary could not be a Selling Shareholder. As proposed, the exemption relies on the independence of each party to the transaction; therefore, the Monitoring Fiduciary must select the Independent Trustee and the Independent Trustee must select the Independent Appraiser. The Department requests comment on the proposed to exclusion of all Selling Shareholders and parties with a financial interest in the Covered Transaction from the Monitoring Fiduciary definition and how best to ensure independence between the Monitoring Fiduciary and Selling Shareholders to protect the ESOP and its participants. The Department also requests comment on whether any other parties, such as executives of the Employer, should be excluded from the definition of Monitoring Fiduciary to further ensure the independence of the Monitoring Fiduciary.

Independent Trustee

Proposed section I(g) defines “Independent Trustee” to mean an individual or entity that would be hired by the Monitoring Fiduciary to serve as the ESOP’s trustee and an ERISA fiduciary with respect to the ESOP transaction. The Independent Trustee could not be the Employer, the Independent Appraiser, a counterparty to the ESOP in the

Covered Transaction, or any other party involved in the Covered Transaction acting on behalf of a party other than the ESOP, or any Affiliate (as defined in the exemption) of any of these listed parties. Further, the proposal provides that the Independent Trustee may not have a relationship to or an interest in any party that could affect the exercise of the Independent Trustee's best judgment in connection with the Covered Transaction and may not have been selected or recommended by a counterparty to the ESOP in the Covered Transaction, or by any other entity that is involved in the Covered Transaction on behalf of any party other than the ESOP. The Independent Trustee would be a fiduciary with respect to the ESOP and is liable if the ESOP enters into a Covered Transaction that does not meet the conditions of this exemption. The Department requests comment on the proposal's definition of an Independent Trustee.

The Department is particularly interested in receiving information regarding whether the party serving as the Independent Trustee should be required to have any specific legal structure or legal authority, such as trust powers under banking law.

Independent Appraiser

Proposed section I(f) defines the term "Independent Appraiser" to mean an individual or an entity that is selected by the Independent Trustee to provide a valuation of the Employer Stock that will be transferred to the ESOP by the Selling Shareholder. The Independent Trustee's authority and responsibility to select the Independent Appraiser must not be a mere formality, but rather would require the Independent Trustee to act with genuine independence, prudence, and loyalty in making the selection. The Independent Appraiser could not be the Employer or an Affiliate, any counterparty to the ESOP in the Covered Transaction, nor any other entity that acts on behalf of any other party in the Covered Transaction. In addition, the Independent Appraiser could not be the Independent Trustee or its Affiliate. The Independent Appraiser also could not have a relationship to, or an interest in, any party that could affect the exercise of the

Independent Appraiser's best judgment in connection with the Covered Transaction nor could it have been selected or recommended by a counterparty to the ESOP in the Covered Transaction or by any other entity that is involved in the Covered Transaction on behalf of any party other than the ESOP.

The Department requests comment on this definition. The Department is particularly interested in receiving comments addressing whether the exemption should require complete independence between the Independent Trustee and Independent Appraiser. As proposed, the Independent Trustee and Independent Appraiser cannot be Affiliates. Alternatively, should the exemption allow the Independent Trustee and Independent Appraiser to be Affiliates, as long as neither has any economic interest in the Selling Shareholder?

Scope of Relief

Proposed section II(a) would provide relief from ERISA section 406(a) and 406(b)(1) and (2), and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (B), (C), (D), and (E) when an ESOP makes an initial purchase of non-publicly traded Employer Stock directly from one or more Selling Shareholders. The exemption would not cover any other type of transaction in which the ESOP acquires other types of employer securities (such as stock appreciation rights, synthetic equity, or other interests that are not common stock) or through a direct purchase from the Employer, or any subsequent purchase by an ESOP that already owns any Employer Stock or other ownership interest in the Employer.

The proposed exemption would provide relief only for an arm's-length transaction in which the ESOP makes its initial purchase of Employer Stock directly from one or more Selling Shareholders. It would not extend relief to transactions that involve a redemption of stock by the Employer and a concurrent sale to the ESOP or similar

transactions, nor would it provide relief for the sale by the Employer of newly created shares of an Affiliate of the Employer (e.g., as part of a spin-off).

The proposal also would not apply to subsequent transactions related to diversification, distributions, and put options. While a Selling Shareholder's sale of Employer Stock directly to the ESOP is a relatively straightforward transaction, ESOP transactions involving redemptions by the Employer could pose unique risks and challenges, potentially requiring different or additional conditions to protect the ESOP and its participants and beneficiaries. Finally, the proposed exemption would not provide relief for transactions involving the sale of Employer Stock to Selling Shareholders by the ESOP.

The Department seeks comment on the proposed scope of the exemption. To the extent commenters request a broader exemption, they should provide a detailed description of the additional transactions the exemption should cover as well as additional safeguards and conditions to protect the interests of the ESOP and its participants and beneficiaries that would be affected by those transactions.

Conditions of the Proposed Exemption

Proposed sections III-VIII set forth the conditions that would apply to a Covered Transaction. These conditions are intended to ensure that (1) the Independent Trustee's representation of the ESOP is truly independent and not tainted by undue influence from the Selling Shareholders, and (2) the determination of the ESOP's Fair Market Value and the Covered Transaction's terms are made with complete independence from the Selling Shareholders' competing interests.

The Department also designed the proposal to ensure that the Independent Appraiser would adhere to appropriate professional standards when performing valuation services to determine the Fair Market Value of the Employer Stock without bias in favor of Selling Shareholders. In furtherance of these critical objectives, all Selling

Shareholders and their relatives, representatives, and entities under their control could not have nor exercise any authority to hire or fire the Independent Trustee, hire or fire the Independent Appraiser, or participate in the ESOP's internal deliberations with respect to the Covered Transaction.

These conditions would ensure that: (1) the Independent Trustee could prudently base its judgment on a reliable appraisal after selecting the Independent Appraiser through a prudent process; (2) the Independent Appraiser has complete, current and accurate information, and that the transaction is conducted at arm's length from the Selling Shareholders; and (3) the price, as determined by the Independent Trustee does not, in fact, exceed fair market value. Therefore, as further discussed below, these conditions address the selection of the Independent Trustee, the selection of and provision of information to the Independent Appraiser, the components of the Independent Appraiser's report, the Independent Trustee's prudent reliance on that report, and the insulation of the ESOP and its fiduciaries from undue influence by the Selling Shareholders. The Department expects that compliance with the proposed exemption's conditions would result in a deliberative process that results in the ESOP paying no more than the Fair Market Value to the Selling Shareholders for the Employer Stock in a Covered Transaction.

General Conditions (Section III)

Under proposed section III(a), the ESOP could not pay a commission with respect to the purchase of the Employer Stock from the Selling Shareholders, and neither the ESOP nor the Employer could pay any of the Selling Shareholders' expenses with respect to the transaction, such as the expenses incurred for any legal and consulting work performed on the Selling Shareholders' behalf. Proposed section III(b) would require the ESOP to be an eligible individual account plan as defined in ERISA section 407(d)(3). These provisions are consistent with the requirements of the statutory exemption in

ERISA section 408(e) to ensure that this proposed administrative safe harbor exemption would include all of the protections the statutory exemption provides.

This proposed administrative safe harbor exemption also would impose additional specific conditions. Under proposed section III(c), the Covered Transaction could not be part of an agreement, arrangement, or understanding, whether written or oral, that is intended to evade compliance with any Federal law, or the requirements of this proposed exemption. Under proposed section III(d), no employee or Selling Shareholder can acquire or receive any warrants, stock appreciation rights, synthetic equity, or other equity-like interest in the Employer, other than Employer Stock in connection with or in anticipation of the Covered Transaction. This condition does not prohibit any party from owning Employer Stock, including through the ESOP. The Department requests comment on this condition, particularly whether additional protective conditions are needed when employees and Selling Shareholders own Employer Stock outside of the ESOP. Under proposed section III(e) the terms of the Covered Transaction would have to be set forth in a written contract between the ESOP and the Selling Shareholder.

Under proposed section III(f), the Department has included an express catchall provision to thwart transactions that are intended to evade or avoid the protective principles set forth in the proposal. The provision is consistent with the statutory exemption and with ERISA's fiduciary duties of prudence and loyalty. This language is intended to avoid any transaction that is structured to prevent participants from receiving the full benefit of the purchase price paid for the common stock by the plan. If, as a matter of economic substance, the transaction is not reasonably expected to result in the ultimate release of shares to plan participants that are worth at least the amount paid per share by the plan to the Selling Shareholders, plus a reasonable rate of return, or the transaction has been designed to generate tax benefits that are disproportionate to the

value actually received by plan participants, the transaction violates the proposed exemption and defeats ERISA's participant-protective goals.

Conditions for Selling Shareholders (Section IV)

Proposed section IV provides specific conditions for the Selling Shareholders. Under proposed section IV(a), a Selling Shareholder, relative or representative of a Selling Shareholder, or any entity under the control of a Selling Shareholder could not:

- have or exercise any authority to participate in the ESOP's decisions or deliberations regarding whether to engage in the Covered Transaction; nor
- participate in negotiating the terms and conditions of the Covered Transaction or any loan or extension of credit in connection with a Covered Transaction (an ESOP loan) on behalf of the ESOP.²²

Under proposed section IV(b), each Selling Shareholder would have to take steps appropriately designed to ensure that no employee, executive, officer, or director of the Employer or their representatives provides information to any Selling Shareholder or its representative about the ESOP's internal decisions, deliberations, work product, or analysis related to the Covered Transaction or ESOP loan, including but not limited to, any analysis or conclusions of the Independent Appraiser. Each Selling Shareholder must also ensure that communications between any Selling Shareholder, or its representative, and the Independent Appraiser would be monitored by the Independent Trustee, and each Selling Shareholder or representative would not improperly influence the Independent Appraiser's analysis and conclusions.

Proposed section IV(c) would require that if any Selling Shareholder enters into a loan or other extension of credit with the Employer in connection with a Covered

²² The terms and conditions include but are not limited to: (1) the selection of the Independent Appraiser, the terms of the Independent Appraiser's engagement, and the determination of the Fair Market Value of the Employer Stock, (2) whether to hire or fire the Independent Trustee, and (3) whether to hire or fire the Independent Appraiser.

Transaction, that loan or extension of credit must be on terms that are identical to the terms of any loan between the ESOP and the Employer in connection with the Covered Transaction. It does little good for the plan to enter into reasonable terms for the extension of credit by the employer, if the company owned by the ESOP simultaneously enters into a one-sided loan favoring Selling Shareholders. In such cases, the loan, which is indirectly financed by the ESOP, would improperly drain value from the Plan's investment in the company.

Proposed section IV(d) ensures that the parties representing the ESOP in the Covered Transaction receive accurate and complete information. No Selling Shareholder could make any material misrepresentations to the Independent Trustee or Independent Appraiser, but that alone is not sufficient to satisfy section IV(d). Under proposed section IV(d)(1), each Selling Shareholder must take steps prudently designed to ensure that the information provided to the Independent Trustee and Independent Appraiser would be complete, current, and accurate. Under proposed section IV(d)(2), each Selling Shareholder(s) must certify in writing, without disclaimers or qualifications, that they have complied with paragraphs IV(a), (b), (c), and (d)(1), and that they are unaware of any material omissions or inaccuracies in the information provided to the Independent Trustee and Independent Appraiser.

This class exemption would require each Selling Shareholder to be able and willing to certify without disclaimers or qualifications that all of the relevant information provided to the Independent Trustee and Independent Appraiser is complete, current, and accurate. This condition applies to both written and oral statements and would not be satisfied if any Selling Shareholder omits (or knows that another party has omitted) information that is needed to make the statement not misleading in light of the circumstances under which it was made. The Department requests comment on this proposed condition, and on each Selling Shareholder's ability to make this certification.

While the proposed exemption generally would require all exemption conditions to be satisfied for any relief to become available, section IV(e) provides a special rule for Selling Shareholders would receive relief even if the other parties to the Covered Transaction would not ultimately comply with each condition and each Selling Shareholder:

- complies with all of the conditions that apply to the Selling Shareholders (i.e., the conditions in proposed sections III and IV(a)-(d) including making no material misrepresentations);
- receives a written certification from all other parties to the transaction certifying compliance with the exemption; and
- neither knows nor reasonably should know that the certifications are false.

Under proposed section IV(e), the Monitoring Fiduciary, the Independent Trustee and the Independent Appraiser would be required to certify in writing that they have complied with the applicable conditions of the exemption and are aware that the Selling Shareholders will rely on their certification in proceeding with the ESOP transaction. Each Selling Shareholder also would be required to provide a certification to the ESOP of its own compliance with the conditions set forth in proposed section IV(a) and (b) of the exemption. This certification would be required to be in writing and could not contain any disclaimers or qualifications.

The Department requests comment on this special rule for Selling Shareholders. The Department is specifically interested in receiving information regarding whether all Selling Shareholders' exemptive relief should depend on whether each other party to the Covered Transaction complies with all applicable conditions.

Conditions for Monitoring Fiduciaries (Section V)

Proposed section V would impose additional conditions on Monitoring Fiduciaries. The Monitoring Fiduciary is obligated to represent the interests of the ESOP

and its participants and beneficiaries in the Covered Transaction. Section V(a) would require the Monitoring Fiduciary to act prudently and loyally on behalf of the ESOP and its participants and beneficiaries, within the meaning of ERISA section 404, when investigating, selecting, and appointing the Independent Trustee to represent the ESOP with respect to the Covered Transaction. The Monitoring Fiduciary also would be required to prudently determine that the Independent Trustee has sufficient financial resources to provide restitution to the plan for losses resulting from any breach by the Independent Trustee of its ERISA fiduciary obligations or the conditions of this exemption. In reaching this conclusion, the Monitoring Fiduciary may consider the amount of fiduciary liability insurance maintained by the Independent Trustee under section VI(d). For purposes of this paragraph, losses include, but are not limited to, any overpayment by the ESOP for the purchase of Employer Stock from the Selling Shareholder (including a reasonable rate of interest).

The Monitoring Fiduciary also would be responsible for providing information to the Independent Trustee. While the obligation of each Selling Shareholder under section IV(d) would be to certify that the information is accurate, complete, and not misleading, the Monitoring Fiduciary would actually provide this information to the Independent Trustee. Under proposed section V(b)(1), the Monitoring Fiduciary would prudently ensure that the Independent Trustee receives, in a timely fashion, complete, current, and accurate information concerning the Employer, its financial condition, as well as any other information that the Independent Trustee or Independent Appraiser requests to discharge its ERISA obligations of prudence and loyalty. Under proposed section V(b)(2), the Monitoring Fiduciary also would make any requested officer, employee, or contractor of the Employer available to the Independent Trustee for interview in connection with the Covered Transaction within 10 business days after the Independent Trustee's request.

Proposed section V(c) would require the Monitoring Fiduciary to ensure that the Employer provides the Independent Trustee with audited, unqualified financial statements for the preceding five fiscal years that are prepared by a certified public accountant, or, if such statements are unavailable for the preceding five fiscal years, as far back as administratively feasible. In all events such statements covering the preceding two fiscal years would have to be provided.

Proposed section V(d) would require the Monitoring Fiduciary to oversee the entire transaction. In order to meet this requirement, the Monitoring Fiduciary would have the authority to (1) replace the Independent Trustee if prudence requires replacement, and (2) prevent the Covered Transaction from occurring if, at any time before or at the time the Covered Transaction occurs, the Monitoring Fiduciary knows or has reason to know that the Independent Trustee has failed to meet its responsibilities under ERISA, the Code, the conditions of this exemption, or its Independent Trustee Contract.

Conditions for Independent Trustees (Section VI)

Proposed section VI would impose conditions on the Independent Trustee. Specifically, proposed section VI(a) would require the Independent Trustee to have appropriate technical training and proficiency with ERISA and the Code, specifically including expertise with respect to ESOPs and the methodologies used to determine the value of non-publicly traded stock. The Department also requests comment on whether any other expertise should be required of the Independent Trustee, such as professional experience in buying and selling businesses in arm's length transactions or industry-specific knowledge or expertise in certain circumstances.

Under proposed section VI(b)(1), the Independent Trustee could not have conflicts of interest with respect to the Covered Transaction that could affect the exercise

of its best judgment as a fiduciary. Regarding prior work, proposed section VI(b)(2) would provide that neither the Independent Trustee nor an Affiliate could have:

- previously performed work for the Employer, any Affiliate, or a Selling Shareholder;
- conducted or participated in a feasibility study of the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder;
- prepared a preliminary stock valuation in connection with the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder; or
- otherwise performed preliminary work regarding the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder.

Regarding compensation, proposed section VI(b)(3) would preclude the Independent Trustee from receiving, or expecting to receive, compensation from the ESOP, the Employer and its Affiliates, or any person or entity assisting in structuring the Covered Transaction or providing advice or financial services to the Employer, an Affiliate, or a Selling Shareholder in connection with the Covered Transaction, that collectively exceeds two percent of the Independent Trustee's gross revenue for the Federal income tax year immediately preceding the year during which the compensation was received. The Department is proposing this condition to ensure that an Independent Trustee would be truly independent of parties to the transaction other than the plan. The Department requests comment on the specifics of this condition and whether it appropriately ensures that the Independent Trustee is truly independent.

Proposed section VI(c) would require the Independent Trustee to enter into a written contract with the ESOP (the Independent Trustee Contract) that (1) would be executed before the performance of any work by the Independent Trustee, and (2) contains an express acknowledgement by the Independent Trustee that it is an ERISA

fiduciary with respect to the ESOP for purposes of the Covered Transaction. The Independent Trustee Contract also would require the Independent Trustee to ensure compliance with the exemption conditions applicable to it at all times and preclude the Independent Trustee from waiving any rights, claims, or remedies of the ESOP against the Independent Trustee under ERISA, the Code, or State law with respect to the Covered Transaction. Further, the Independent Trustee Contract could not permit the Independent Trustee's compensation to vary based on the price paid by the ESOP to the Selling Shareholder for the Employer Stock in the Covered Transaction, the structure of the Covered Transaction, or whether the Independent Trustee approves the Covered Transaction. Lastly, the Independent Trustee Contract could not include any contractual provision that would provide for the direct or indirect indemnification or reimbursement of the Independent Trustee by the ESOP, Employer, Selling Shareholder, or any Affiliates thereof for any violation of Federal or State law that may be attributable to the Independent Trustee's performance of its duties in connection with the Covered Transaction.

In addition, no contract or instrument could purport to waive the Independent Trustee's liability for violations of any Federal or State law. The Department notes that nothing in the proposed exemption would prevent an Independent Trustee from receiving a monetary advance from the Employer for the defense of any fiduciary breach claims if (i) the Independent Trustee agrees to repay any funds it was advanced by the Employer in a timely fashion with a reasonable rate of interest if the Independent Trustee is found liable in a court judgment for breach of its fiduciary duties in connection with the Covered Transaction or enters into a monetary or other settlement with respect to those breaches of fiduciary duty, and (ii) the Independent Trustee posts adequate security for the funds that were advanced by the Employer.

Under proposed section VI(d), the Independent Trustee must have sufficient

financial resources to provide restitution to the plan for losses resulting from any breach by the Independent Trustee of its ERISA fiduciary obligations or the conditions of this exemption. These losses may include, but are not limited to, any overpayment by the ESOP for the purchase of Employer Stock (plus a reasonable rate of interest). While the Monitoring Fiduciary would be obligated under proposed section V(a)(2) to determine that the Independent Trustee has sufficient financial resources to provide restitution to the plan for losses resulting from any breach by the Independent Trustee of its ERISA fiduciary obligations or the conditions of this exemption, proposed section VI(d) also would impose this requirement on the Independent Trustee. The Independent Trustee could not blindly rely on the finding of the Monitoring Fiduciary if the Independent Trustee knows or should know that the Monitoring Fiduciary's determined amount would be insufficient.

In determining whether the Independent Trustee has sufficient financial resources, the Monitoring Fiduciary may consider the amount of fiduciary liability insurance maintained by the Independent Trustee under proposed section VI(d). The Department believes that fiduciary liability insurance would be sufficient if it is available to cover losses equaling at least 20 percent of the purchase price. The insurance could not contain an exclusion for actions brought by the Secretary of Labor, the ESOP, or plan participants or beneficiaries. The Department requests comment on this condition regarding whether (i) there are other ways to ensure that the Independent Trustee has sufficient resources, and (ii) 20 percent is an appropriate threshold that both protects participants' interests in effective remedies and gives parties sufficient clarity. Proposed section VI(e) would require the Independent Trustee to preserve its independence. In particular, the Independent Trustee must take steps prudently designed to ensure that (A) no employee, executive, officer, or director of the Employer provides information to any Selling Shareholder or its representative about the ESOP's internal decisions, deliberations, or

analysis related to the Covered Transaction or ESOP loan, including but not limited to, any analysis or conclusions of the Independent Appraiser, and (B) communications between the Selling Shareholders, their representatives, and the Independent Appraiser are monitored by the Independent Trustee, and (C) the Selling Shareholders and their representatives do not improperly influence the Independent Appraiser's analysis and conclusions, e.g., by suggesting or advocating for a particular determination as to the Fair Market Value for the Employer Stock.

Proposed section VI(f) would require the Independent Trustee to use prudence and loyalty when selecting the Independent Appraiser, because the Independent Trustee would have the sole fiduciary authority to engage an Independent Appraiser to value the Employer Stock. The Independent Trustee must act prudently and loyally, within the meaning of ERISA section 404, when investigating, selecting, and appointing an Independent Appraiser. Before engaging an Independent Appraiser to determine the Fair Market Value for the Employer Stock, the Independent Trustee must prepare a careful written analysis that sets forth the reason for selecting the Independent Appraiser. The analysis must include a list of all of the appraisers that the Independent Trustee considered and a discussion of the qualifications of the appraisers that the Independent Trustee considered.

Regarding the Independent Appraiser that is selected, the Independent Trustee must document: a complete list of references the Independent Trustee checked and a discussion of each reference's comments regarding the Independent Appraiser; whether the Independent Appraiser has the requisite integrity to perform the engagement, as well as whether the Appraiser was the subject of prior criminal or civil proceedings; that the Independent Appraiser does not have relationships with any parties to the transaction that might influence the Independent Appraiser in the performance of the valuation; and a full explanation of the bases for concluding that the Independent Trustee's selection of the

Independent Appraiser was prudent within the meaning of ERISA section 404.

Lastly, proposed section VI(g) would impose conditions on the Independent Trustee's decision to engage in the Covered Transaction. Many of these conditions are also requirements of the Department's proposed Adequate Consideration regulation published elsewhere in this issue of the *Federal Register* and are intended to ensure that the Independent Trustee would not cause or commit the ESOP to pay, directly or indirectly, more than Fair Market Value for the Employer Stock on the date of the Covered Transaction. The Independent Trustee must act prudently and loyally within the meaning of ERISA sections 404(a)(1)(A) and (B) to determine that the Independent Appraiser's report would satisfy the requirements of proposed section VII(d) of this exemption, and that reliance on the Independent Appraiser's report must be prudent and reasonably justified under the circumstances based on the Independent Trustee's careful consideration of all aspects of the Covered Transaction. The Department requests comments on the specifics set forth in proposed section VI(g).

The Independent Trustee (not the Independent Appraiser) would be solely responsible for determining the Fair Market Value of the Employer Securities and terms of the Covered Transaction, and for zealously negotiating over the terms, structure, and cost of the stock purchase with prudence and undivided loyalty to the ESOP and its participants and beneficiaries to ensure that the Covered Transaction is in the interests of and protective of ESOP participants and beneficiaries. In addition, the Independent Trustee must act with prudence and loyalty in representing the interests of the ESOP in negotiations on the terms of the Covered Transaction, ESOP loan, and Fair Market Value of the Employer Stock without regard to the interests of any party other than the ESOP, its participants, and beneficiaries, and enter into the Covered Transaction only if it is in the interest of the ESOP, its participants, and beneficiaries and protective of the rights of participants and beneficiaries; and conclude, based on its critical and prudent review of

the Independent Appraiser's report and all material facts, that the ESOP would pay no more than Fair Market Value for Employer Stock as of the date of the Covered Transaction.

The Independent Trustee would be required to document its internal deliberation, including (A) the identities of the Independent Trustee's personnel who were primarily responsible for engaging in the Covered Transaction, including any person who participated in the decision on whether to proceed with the Covered Transaction or the Fair Market Value for the Employer Stock; (B) any deliberations concerning the Independent Trustee's approval of the Covered Transaction or the conclusions and analysis set forth in the report; (C) any material points as to which the Independent Trustee's personnel disagreed and the substance of the disagreements; and (D) any concerns expressed by the Independent Trustee's personnel regarding the reliability of the Independent Appraiser's report, its conclusions, or analysis.

Under proposed section VI(h), the Independent Trustee must prudently ensure that any dividends on the Employer Stock are reasonably expected to be paid to the ESOP for ultimate allocation to participant accounts, and not to repay any debt incurred by the ESOP in connection with the Covered Transaction or to defray Employer contributions to the ESOP.

Conditions for Independent Appraisers (Section VII)

Proposed section VII would impose conditions on the Independent Appraiser. The Independent Appraiser must be qualified to perform the valuation services and perform such services in conformance with appropriate professional standards, and may not disclaim liability, through contractual limitations, indemnities, or otherwise, if it fails to perform valuation services in accordance with professional standards, such as by limiting its liability for negligent work.

Under Proposed section VII(a), the Independent Appraiser must have appropriate technical training and proficiency with respect to the valuation of non-publicly traded stock and any other analyses required by the Independent Trustee and be subject to appropriate professional standards in performing the valuation services. Proposed section VII(b)(1) would require the Independent Appraiser to have no conflicts of interest that could impair its judgment regarding any aspect of the Covered Transaction. Proposed section VII(b)(2) would provide that neither the Independent Appraiser nor any Affiliate could have previously performed work for or on behalf of the Employer, any Affiliate, or a Selling Shareholder, particularly including, but not limited to (i) conducting or participating in a feasibility study of the Covered Transaction, (ii) preparing a preliminary stock valuation in connection with the Covered Transaction, or (iii) otherwise performing preliminary work regarding the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder. Also, the Independent Appraiser must not have recommended or referred, or been recommended or referred by, the Independent Trustee to the Employer, any Affiliate, a Selling Shareholder, or any fiduciary of the ESOP to perform work in connection with the Covered Transaction. However, the exemption would allow the Independent Appraiser or its Affiliate to have performed prior work exclusively on behalf of the ESOP.

Regarding compensation, proposed section VII(b)(3) provides that the Independent Appraiser could not receive, or expect to receive, revenue from the ESOP, the Employer and its Affiliates, or any person or entity assisting in structuring the Covered Transaction or providing advice or financial services to the Employer or a Selling Shareholder in connection with the Covered Transaction, that collectively exceeds two percent of the Independent Appraiser's gross revenue for the prior Federal income tax year. The Independent Appraiser also could not take direction from or share

its analysis or conclusions regarding any aspect of the Covered Transaction with any party other than the Independent Trustee.

Proposed section VII(c) would require the Independent Trustee to enter into a written contract with the Independent Appraiser before the Independent Appraiser performs any work on behalf of the ESOP. The contract would set forth the duties of the Independent Appraiser, including a requirement for the Independent Appraiser to comply with all of the applicable conditions of this exemption. Proposed section VII(c)(3) would prohibit contracts from including certain indemnification provisions.

Under proposed section VII(d), the Independent Appraiser would be required to prepare a written report that:

- sets forth the Fair Market Value for the Employer Stock;
- analyzes whether the Covered Transaction is financially fair and in the best interest of the ESOP;
- assesses the impact of the Covered Transaction on the financial viability of the Employer; and
- examines the ability of the Employer to service any debt obligations, including but not limited to, obligations incurred in connection with the Covered Transaction.

While the Independent Trustee is solely responsible for the execution of the Covered Transaction and would be required to make their own determination that the Covered Transaction is in the ESOP's best interest, the Department expects that the Independent Trustee would insist upon and prudently rely upon a sound Independent Appraiser's report. Therefore, the Department is proposing specific conditions in proposed section VII(d) governing the contents of Independent Appraisers' analysis in their reports. For example, the Independent Appraiser must certify in writing that the opinions and analyses set forth in the written report are based on and consistent with

complete, current, and accurate data, adhere to standards that an expert in like capacity and familiar with such matters would use when creating the written report, and reflect the reasonable exercise of professional judgment without bias in favor of the Selling Shareholders. The purpose of this condition is to ensure that the Independent Appraiser cannot disclaim liability for its report but must be willing to stand behind it.

The Department requests comment on these proposed conditions and whether these specific content requirements would provide helpful information to Independent Trustees that ultimately would protect ESOPs and their participants and beneficiaries from the risks associated with engaging in Covered Transactions.

Recordkeeping (Section VIII)

Proposed section VIII would impose recordkeeping conditions on the Independent Trustee that would require them to maintain the records necessary to determine whether the conditions of this exemption have been met with respect to a Covered Transaction for six years from the date of the Covered Transaction. Although the exemption would only require records to be maintained for six years, the Independent Trustee may decide to keep the records longer for other purposes. The records would be required to be reasonably accessible for examination and to be provided to the Department's Office of Exemption Determinations within 30 days after the date of the Department's request. If such records are lost or destroyed due to circumstances beyond the control of the responsible party, the Department would not deem a prohibited transaction to have occurred solely based on the unavailability of those records. No party other than the party responsible for maintaining the records would be subject to the civil penalty the Department may assess under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if the records are not maintained or are not available for examination as required by proposed section VIII(b).

The records would be required to be made available to specified parties, including

any authorized employee or representative of the Department or Department of Treasury, including the Internal Revenue Service. However, none of these parties would be authorized to examine records regarding a Covered Transaction involving privileged trade secrets or privileged commercial or financial information of the Employer, Independent Trustee, or Independent Appraiser, or information identifying other individuals. If the Independent Trustee refuses to disclose information pursuant to the preceding paragraph on the basis that the information is exempt from disclosure, the party would be required to provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information by the close of the thirtieth (30th) day following the request. Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met would result in the loss of the exemption only for the Covered Transaction for which records were missing or had not been maintained. The failure to maintain records for a Covered Transaction does not affect the relief for other Covered Transactions for which such required records are maintained. The Department requests comment on whether any parties in addition to the Independent Trustee should be required to maintain records.

Request for Comments on Other Potential Safe Harbor Exemptions

The Department would also welcome comments on ways in which it might construct a safe harbor for transactions that relied, in part, on the participation of sophisticated independent parties, such as lenders and investors, to validate the prudence of the purchase price and to protect the interests of plan participants. For example, the willingness of a sophisticated independent investor to buy the same stock on the same terms as the ESOP, without benefit of any special inducements or agreements, could reduce concern that the stock is overvalued because of the Selling Shareholder's undue influence over the transaction. If the Department sought to construct such a safe harbor, what additional conditions would be necessary to ensure that the stock was purchased for

no more than fair market value, and that the participant-protective standards of section 408 of ERISA were satisfied? How would independence of the other lenders or investors be determined? How large a stake would the independent investor need to have before it would be appropriate to rely on the outside investment as providing some validation of the fair market value of the stock? Are special protections necessary to protect the interest of plan participants in circumstances where the independent investor acquires a potentially controlling interest in the company? How should such a safe harbor account for differences in the parties' anticipated degree of control over major corporate actions, differences in the likely duration of the plan's and independent investor's investments, or differences in the parties' interest in protecting the employees' ongoing stake and involvement in the enterprise? Should relief be conditioned on the availability of retirement investments outside the ESOP, such as in a separate retirement plan that does not include employer stock as an investment option? What, if anything, should the safe harbor say about the terms on which the transaction is financed? Are there any other market-based mechanisms to facilitate price discovery, including commercial terms for the transaction, that a safe harbor could use to ensure the ESOP does not pay more than fair market value for employer stock, and could increase participation from other service providers to the ESOP?

Similarly, would it be possible to structure an additional or alternative safe harbor for leveraged ESOP transactions that relied, in part, on an independent and sophisticated financial institution's agreement to finance the transaction, without additional seller financing? For example, would it be possible to structure a safe harbor that limits the purchase price to the amount financed by the independent lender, notwithstanding the stock's purported higher fair market value, unless the company subsequently met specified metrics that validated the fair market value and were consistent with the valuation's projections of future performance. If, for example, the parties concluded that

the fair market value of the stock was \$100 million, but the lender was willing to lend only \$70 million, would it be possible to structure an appropriately protective exemption that permitted the Selling Shareholders to receive more than \$70 million in payments only if certain financial metrics were met in a way that demonstrated that the company's subsequent performance was, in fact, consistent with the \$100 million valuation? What would be appropriate conditions for such an exemption? What sort of oversight would be needed to determine that the benchmarks had been satisfied?

Additionally, the Department is interested in receiving comments on the extent to which it could provide additional certainty to parties relying on a safe harbor administrative class exemption (e.g., by entertaining applications for individual exemptions from parties that relied on the safe harbor but would like the certainty that comes with an exemption expressly focused on their particular transaction). Under the Department's Procedures Governing the Filing and Processing of Prohibited Transaction Exemption Applications,²³ the Department may grant an exemption that provides retroactive relief for past prohibited transactions if, among other things, the Department determines that appropriate safeguards were in place at the time the exemption transaction was consummated, and no plan participants or beneficiaries were harmed by the exemption transaction. The Department is especially interested in receiving comments regarding whether parties would be more likely to comply with the fiduciary guideposts described in this proposed Class Exemption if a specific process were available to grant such individual exemptions on a retroactive basis. How likely would parties be to take advantage of such a process for individual transactions? Is there another process through which the Department could provide certainty to ESOPs purchasing employer stock? How should the process be structured in a way that would be

²³ 29 CFR 2570.30(b).

administratively feasible and meet the other plan and participant-protective standards set forth in ERISA section 408(a)?

Executive Orders 12866, 14094, and 13563

Executive Orders 12866 (as amended by 14094) and 13563 direct agencies to assess all costs and benefits of available regulatory alternatives. If regulation is necessary, agencies must select regulatory approaches that maximize net benefits, including potential economic, environmental, public health and safety effects, distributive impacts, and equity. Executive Order 13563 emphasizes the importance of quantifying costs and benefits, reducing costs, harmonizing rules, and promoting flexibility.

Under Executive Order 12866, “significant” regulatory actions are subject to review by the Office of Management and Budget (OMB). As amended by Executive Order 14094 section 3(f) of the Executive Order 12866 defines a “significant regulatory action” as any regulatory action that is likely to result in a rule that may:

- (1) have an annual effect on the economy of \$200 million or more (adjusted every 3 years by the Administrator of Office of Information and Regulatory Affairs (OIRA) for changes in gross domestic product); or adversely affect in a material way the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, territorial, or Tribal governments or communities;
- (2) create a serious inconsistency or otherwise interfere with an action taken or planned by another agency;
- (3) materially alter the budgetary impacts of entitlement grants, user fees, or loan programs or the rights and obligations of recipients thereof; or
- (4) raise legal or policy issues for which centralized review would meaningfully further the President’s priorities or the principles set forth in this Executive

order, as specifically authorized in a timely manner by the Administrator of OIRA in each case.

It has been determined that this rulemaking is significant within the meaning of section 3(f)(4) of the Executive Order, but not under section 3(f)(1). Therefore, the Department has provided an assessment of the potential costs, benefits, transfers, and alternatives and OMB has reviewed the proposed rulemaking. The impact of this rulemaking is included in the regulatory impact analysis for the entire rulemaking, which can be found in the related notice of rulemaking found elsewhere in this issue of the *Federal Register*.

Paperwork Reduction Act

As part of its continuing effort to reduce paperwork and respondent burden, the Department conducts a preclearance consultation program to allow the general public and Federal agencies to comment on proposed and continuing collections of information in accordance with the Paperwork Reduction Act of 1995 (PRA).²⁴ This helps to ensure that the public understands the Department's collection instructions, respondents can provide the requested data in the desired format, reporting burden (time and financial resources) is minimized, collection instruments are clearly understood, and the Department can properly assess the impact of collection requirements on respondents.

Currently, the Department is soliciting comments concerning the proposed information collection request (ICR) included in the Proposed ESOP Prohibited Transaction Exemption. To obtain a copy of the ICR, contact the PRA addressee shown below or go to www.RegInfo.gov.

The Department has submitted a copy of the proposed rule to the Office of Management and Budget (OMB) in accordance with 44 U.S.C. § 3507(d) for review of

²⁴ 44 U.S.C. § 3506(c)(2)(A) (1995).

its information collections. The Department and OMB are particularly interested in comments that:

- Evaluate whether the collection of information is necessary for the functions of the agency, including whether the information will have practical utility;
- Evaluate the accuracy of the agency’s estimate of the burden of the collection of information, including the validity of the methodology and assumptions used;
- Enhance the quality, utility, and clarity of the information to be collected; and
- Minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology (e.g., permitting electronic submissions of responses).

Commenters may send their views on the Department’s PRA analysis in the same way they send comments in response to the proposed rulemaking as a whole (for example, through the www.regulations.gov website), including as part of a comment responding to the broader proposed rule. Comments are due by [INSERT DATE 75 DAYS AFTER DATE OF PUBLICATION IN THE *FEDERAL REGISTER*] to ensure their consideration.

ICRs are available at RegInfo.gov (reginfo.gov/public/do/PRAMain). Requests for copies of the ICR can be sent to the *PRA addressee*:

By mail	PRA Officer Office of Research and Analysis Employee Benefits Security Administration U.S. Department of Labor 200 Constitution Avenue NW Room N-5718 Washington, DC 20210
By email	ebsa.opr@dol.gov

The Department invites comments addressing its estimate of the costs associated with the proposed class exemption, as well as any quantifiable data that would support or contradict any aspect of its analysis. Specifically, the Department requests comment on:

- (1) How common it is, under the current regulatory environment, to hire an Independent Fiduciary or Independent Appraiser in transactions covered by the proposed class exemption;
- (2) Whether the proposed class exemption would encourage more employers to sponsor ESOPs based on initial stock transactions that comply with the adequate consideration requirement;
- (3) How often entities would rely on the proposed class exemption (specifically whether the Department's estimate of 25 percent of transactions eligible for the proposed class exemption ultimately relying on it is reasonable);
- (4) How the restriction of the proposed class exemption to operating companies (as that term is defined in 29 CFR 2510.3-101(c)) would affect the number of transactions conducted under the proposed class exemption;
- (5) What types of professionals would be involved with satisfying the requirements of the proposed rulemaking (and whether the Department's labor cost estimates are appropriate); and
- (6) How the requirements in the proposal would affect the cost to engage an Independent Appraiser to compose a valuation report.

Summary of Analysis

Trustees that have complied with ERISA section 404 and followed additional guidance provided by the Department are likely already performing much of the required work and documentation. While the incremental burden of the proposed class exemption is small, the full burden of the requirements is included below to allow for evaluation of the requirements in the required information collection.

Summary of Affected Entities and Transactions

The Department's estimate of the number of transactions that would rely on the proposed exemption is shown in table 1. This estimate relies on the following data points and assumptions.

- (1) In 2022, there were 6,465 ESOPs, of which 3,024 were large plans, defined as having 100 or more participants, while 3,415 ESOPs were small plans, defined as having less than 100 participants.²⁵
- (2) Relying on statistics from NCEO, the Department assumes 91.4 percent of ESOPs (81.8 percent of large ESOPs and 100 percent of small ESOPs) hold stock that is not readily tradable on an established securities market.²⁶
- (3) According to the Department's analysis of Form 5500 data, over the past 10 years, new, leveraged ESOPs have accounted for 2.8 percent of total ESOPs and new, non-leveraged ESOPs have accounted for 1.4 percent of total ESOPs, on average.
- (4) In the Department's experience, approximately 40 percent of non-leveraged, new ESOPs become leveraged in the following years.²⁷ After making this adjustment, the Department estimates that approximately 3.3 percent of ESOPs are new ESOPs engaging in a leveraged transaction, while 0.8 percent of ESOPs are new ESOPs engaging in a non-leveraged transaction.

²⁵ U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 2022 Form 5500 Annual Reports*, forthcoming.

²⁶ The NCEO estimated that there were 5,973 ESOPs in privately held companies and 560 ESOPs in publicly traded companies in 2021. Based on these values, the Department estimates that 91.4 percent of ESOPs are held by privately held companies. In addition, the NCEO estimates that there are 3,421 small plans held by private companies. Comparing this to the number of small plans in the Form 5500, the Department expects that nearly all small ESOPs will be in privately held companies, and that all 560 ESOPs in publicly traded companies correspond to large plans. As such, in this analysis, the Department assumes that all small ESOPs are in privately held companies and that approximately 81.8 percent of large ESOPs are held in privately held companies. See National Center for Employee Ownership, *Employee Ownership by the Numbers*, (Feb. 2024), <https://www.nceo.org/articles/employee-ownership-by-the-numbers>; U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 2022 Form 5500 Annual Reports*, forthcoming.

²⁷ This estimate is based on an ad hoc analysis of new ESOPs that reported being non-leveraged in 2021 and 2022.

(5) Given the degree of uncertainty of how many transactions would rely upon the proposed class exemption, the Department estimates that approximately 25 percent of eligible transactions would rely on the class exemption annually.

For a more in-depth discussion on the Department's methods, refer to the Regulatory Impact Analysis (RIA) of the Department's proposed Adequate Consideration regulation published elsewhere in this issue of the *Federal Register*.

Table 1 — Estimate of Transactions Affected Annually

	<i>Percent of ESOPs that are Not Publicly ESOPs</i>	<i>Percent Engaging in Non- leveraged Transactions</i>	<i>Percent Engaging in Leveraged Transactions</i>	<i>Non- leveraged Transactions</i>	<i>Leveraged Transactions</i>	<i>Total Transactions</i>	
	(A)	(B)	(C)	(D)	(E) = (A x B x C)	(F) = (A x B x D)	(G) = (E + F)
<i>Transactions Affected by the Proposed Class Exemption</i>					47	195	242
<i>Large ESOPs</i>	3,050	81.8%	0.8%	3.3%	20	82	102
<i>Small ESOPs</i>	3,415	100.0%	0.8%	3.3%	27	113	140
<i>Transactions Assumed to Rely on the Proposed Class Exemption</i>					12	49	61
<i>Large ESOPs</i>	763 ^a	81.8%	0.8%	3.3%	5	21	26
<i>Small ESOPs</i>	854 ^a	100.0%	0.8%	3.3%	7	28	35

^a The Department assumes that only 25 percent of transaction eligible for exemptive relief would rely on the proposed class exemption.

This analysis assumes that the number of covered transactions, and as a result the number of affected ESOPs, would remain constant over time. However, the Department acknowledges that the number of covered transactions in future years may be affected in the future by the establishment of the Department's Employee Ownership Initiative, State programs promoting employee ownership, and the proposed class exemption's guidance for the successful first-time purchase of employer common stock. The Department requests comment on how such initiatives, programs, and the proposed regulation would affect the number of transactions under the proposed class exemption.

Summary of Burden and Costs

The Department has identified the following collections of information in the requirements of the proposed class exemption:

- (1) Section IV would provide a special rule for Selling Shareholders to rely on the exemption if they provide a written certification of compliance with the exemption and receive written certifications from the other parties confirming compliance with the proposed class exemption’s conditions.
- (2) Section VI would require the Independent Trustee to enter into a written contract with the ESOP.
- (3) Section VII would require an Independent Appraiser to enter into a written contract with the Independent Trustee.
- (4) Section VII would require specific information to be included in the written valuation report.

Table 2 summarizes the estimate hour and cost burdens associated with each information collection requirement. The Department’s considerations and estimation methods are described in more detail in the RIA of the Department’s proposed Adequate Consideration regulation published elsewhere in this issue of the *Federal Register*. Table 2 includes the section of the RIA where the discussion is included.

	<i>Description of Burden</i>	<i>Associated RIA Section</i>	<i>Hour Burden</i>	<i>Equivalent Cost Burden</i>	<i>Cost Burden</i>
Section IV	Written Certifications	7.5.2	122	\$26,050	\$0
Section VI	Independent Trustee Contract	7.5.4	31	\$5,428	\$0
Section VII	Independent Appraiser Contract	7.5.5	31	\$7,597	\$0
Section VII	Valuation Report	7.5.5	0	\$0	\$105,500
Total Cost			183	\$39,075	\$105,500

A summary of paperwork burden estimates follows:

Type of Review: New collection

Agency: Employee Benefits Security Administration, U.S. Department of Labor.

Title: Proposed ESOP Prohibited Transaction Exemption

OMB Control Number: 1210–NEW.

Affected Public: Businesses or other for-profits; not for profit institutions.

Estimated Number of Respondents: 61

Estimated Number of Annual Responses: 427

Frequency of Response: Occasionally

Estimated Total Annual Burden Hours: 183

Estimated Total Annual Burden Cost: \$105,500

Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA)²⁸ imposes certain requirements on rules subject to the notice and comment requirements of section 553(b) of the Administrative Procedure Act or any other law.²⁹ Under section 603 of the RFA, agencies must submit an initial regulatory flexibility analysis (IRFA) of a proposal that is likely to have a significant economic impact on a substantial number of small entities, such as small businesses, organizations, and governmental jurisdictions.

This proposed class exemption is part of a rulemaking regarding the definition of Adequate Consideration published elsewhere in this issue of the *Federal Register*, which the Department has determined likely will have a significant economic impact on a substantial number of small entities. The impact of this rulemaking on small entities is included in the IFRA for the entire rulemaking, which can be found in the related notice of rulemaking found elsewhere in this edition of the *Federal Register*.

Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 requires each Federal agency to prepare a written statement assessing the effects of any Federal mandate in a

²⁸ 5 U.S.C. 601 *et seq.*

²⁹ 5 U.S.C. 601(2), 603(a); *also see* 5 U.S.C. 551.

proposed or final agency rule that may result in an expenditure of \$100 million or more (adjusted annually for inflation with the base year 1995) in any 1 year by State, local, and Tribal governments, in the aggregate, or by the private sector.³⁰ For purposes of the Unfunded Mandates Reform Act this proposed class exemption does not include any Federal mandate that the Department expects would result in such expenditures by State, local, or Tribal governments, or the private sector.

Federalism Statement

Executive Order 13132 outlines fundamental principles of federalism, and requires the adherence to specific criteria by Federal agencies in the process of their formulation and implementation of policies that have “substantial direct effects” on the States, the relationship between the national government and States, or on the distribution of power and responsibilities among the various levels of government.³¹ Federal agencies promulgating regulations that have federalism implications must consult with state and local officials and describe the extent of their consultation and the nature of the concerns raised in the preamble to the final rule.

In the Department’s view, the proposed rulemaking would not have federalism implications because it would not have direct effects on the states, on the relationship between the national government and the states, nor on the distribution of power and responsibilities among various levels of government. ERISA section 514 provides, with certain exceptions specifically enumerated, that the provisions of ERISA Titles I and IV supersede any and all laws of the states as they relate to any ERISA covered employee benefit plan. The requirements implemented in this proposed class exemption do not alter the fundamental provisions of the statute with respect to employee benefit plans, and as

³⁰ 2 U.S.C. 1501 et seq. (1995).

³¹ Federalism, 64 FR 153 (Aug. 4, 1999).

such will have no implications for the states or the relationship or distribution of power between the national government and the states.

The Department welcomes input from states regarding this assessment.

General Information

The attention of interested persons is directed to the following: (1) The fact that a transaction is the subject of an exemption under ERISA section 408(a) and Code section 4975(c)(2) does not relieve a fiduciary, or other party in interest or disqualified person with respect to a Plan, from certain other provisions of ERISA and the Code, including any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of ERISA section 404 which require, among other things, that a fiduciary act prudently and discharge his or her duties respecting the plan solely in the interests of the participants and beneficiaries of the plan. Additionally, the fact that a transaction is the subject of an exemption does not affect the requirement of Code section 401(a) that the plan must operate for the exclusive benefit of the employees of the employer maintaining the plan and their beneficiaries; (2) Before the proposed exemption may be granted under ERISA section 408(a) and Code section 4975(c)(2), the Department must find that it is administratively feasible, in the interests of plans and their participants and beneficiaries and IRA owners, and protective of the rights of participants and beneficiaries of the plan and IRA owners; (3) If granted, the proposed exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the exemption; and (4) The proposed exemption, if granted, is supplemental to, and not in derogation of, any other provisions of ERISA and the Code, including statutory or administrative exemptions and transitional rules.

Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

**PROPOSED SAFE HARBOR EXEMPTION FOR INITIAL ACQUISITION OF
EMPLOYER COMMON STOCK BY ESOPs FROM SELLING
SHAREHOLDERS**

Section I. Definitions

(a) An “*Affiliate*” of a person or entity means:

(1) Any entity directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with, the person or entity;

(2) Any officer, director, partner, employee, or relative (as defined in ERISA section 3(15)), of the person or entity; and

(3) Any corporation or partnership of which the person or entity is an officer, director, or partner.

(b) “*Employee Stock Ownership Plan*” or “*ESOP*” means a defined contribution employee benefit plan, or portion of such plan, that is designed to satisfy the requirements of an “Employee Stock Ownership Plan” within the meaning of both Code section 4975(e)(7) and ERISA section 407(d)(6) and the regulations thereunder.

(c) “*Employer*” means a C corporation or an S corporation that is an operating company (as that term is defined in 29 CFR 2510.3-101(c)) and that sponsors the ESOP and employs employees covered by the ESOP. For purposes of this exemption, the term Employer includes any company that is a member of the same controlled group of corporations as the employing company as the term “Control Group of Corporations” is defined in Code section 409(l)(4).

(d) “*Employer Stock*” means common stock of the Employer. Common stock refers to “Employer Securities” as defined in Code section 409(l), but does not include preferred or convertible preferred stock, irrespective of Code section 409(l)(3), or other securities, debt instruments, synthetic equity, or other types of ownership interests.

(e) “*Fair Market Value*” means the price at which the Employer Stock would change hands in an arm’s length transaction between a willing buyer and a willing seller when the former is not under any compulsion to buy and the latter is not under any compulsion to sell, and both parties are able and willing to trade and are well informed about all the facts relevant to the stock’s value. For this purpose, the Fair Market Value is determined on the same basis as if the ESOP were purchasing the Employer Stock on a cash or cash equivalent basis, and without any increase in price based on consideration of the terms of the debt used to finance the Covered Transaction.

(f) “*Independent Appraiser*” means a person that:

(1) Is not the Employer or an Affiliate, the Independent Trustee or an Affiliate, a counterparty to the ESOP in the Covered Transaction, or any other entity that is involved in the Covered Transaction on behalf of any party other than the ESOP;

(2) Does not have a relationship to or an interest in any party described in (1) that could affect the exercise of the person’s best judgment in connection with the Covered Transaction; and

(3) Was not selected or recommended by a counterparty to the ESOP in the Covered Transaction, or by any other entity that is involved in the Covered Transaction on behalf of any party other than the ESOP.

(g) An “*Independent Trustee*” means a person that is a trustee of the ESOP and:

(1) Is not the Employer or an Affiliate, the Independent Appraiser or an Affiliate, a counterparty or an Affiliate to the ESOP in the Covered Transaction, or any other party involved in the Covered Transaction (or their Affiliates) on behalf of any party other than the ESOP;

(2) Does not have a relationship to or an interest in any party described in (1) that could affect the exercise of the person’s best judgment in connection with the Covered Transaction; and

(3) Was not selected or recommended by a counterparty to the ESOP in the Covered Transaction, or by any other entity that is involved in the Covered Transaction on behalf of any party other than the ESOP.

(h) The “*Independent Trustee Contract*” is a written contract between the Independent Trustee and the ESOP as described in section VI(c) of this exemption.

(i) “*Monitoring Fiduciary*” means the fiduciary that has authority to hire, monitor, or fire the Independent Trustee. The Monitoring Fiduciary cannot be a Selling Shareholder or have a financial interest in the Covered Transaction.

(j) A “*Selling Shareholder*” is an individual or operating company (as that term is defined in 29 CFR 2510.3-101(c)) that sells shares of the Employer Stock directly to the ESOP in a Covered Transaction.

Section II. Covered Transaction

(a) Covered Transaction.

If the conditions of sections III through VIII are satisfied, this exemption provides relief for Selling Shareholders, Monitoring Fiduciaries, Independent Trustees, and Independent Appraisers from the prohibitions of ERISA section 406(a), 406(b)(1) and (2), and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(A), (B), (C), (D), and (E) when an ESOP that does not already own any Employer Stock or other ownership interest in the Employer makes an initial acquisition of non-publicly traded Employer Stock directly from a Selling Shareholder (a Covered Transaction). This exemption does not cover any other type of transaction in which the ESOP acquires Employer Stock, such as through a direct purchase from the Employer or in a public market transaction or transaction that involves the grant of other types of equity interests or equity-like interests, including but not limited to warrants, stock appreciation rights, or synthetic equity.

(b) Effect of Non-Compliance.

Except as provided in section IV(c), relief under this exemption is dependent on satisfaction of all of the exemption's conditions by Selling Shareholders, Monitoring Fiduciaries, Independent Trustees, and Independent Appraisers at all times.

Section III. General Conditions

(a) No Commission or Selling Shareholder Expenses.

(1) No commission is charged with respect to the Covered Transaction.

(2) Neither the ESOP nor the Employer pays any of the Selling Shareholders' expenses with respect to the Covered Transaction, such as the expenses incurred for any legal and consulting work performed on the sellers' behalf.

(b) Individual Account Plan.

The ESOP is an eligible individual account plan as defined in ERISA section 407(d)(3).

(c) Agreement, Arrangement, or Understanding.

The Covered Transaction is not part of an agreement, arrangement, or understanding, whether written or oral, designed to evade compliance with any Federal law, or the requirement of this exemption that the ESOP pay no more than Fair Market Value for the Employer Stock as determined at the time of the transaction.

(d) Common Stock.

No Selling Shareholder, employee, or other party can acquire or receive any warrants, stock appreciation rights, synthetic equity, or other equity-like interest, other than Employer Stock in connection with or in anticipation of the Covered Transaction.

(e) Written Contract.

The terms of the Covered Transaction are set forth in a written contract between the ESOP and the Selling Shareholder.

(f) Anti-evasion.

An Independent Trustee may not approve a Covered Transaction if:

- (1) the transaction is not reasonably expected to result in the ultimate release of Employer Stock to plan participants that is worth at least the amount paid per share by the ESOP, plus a reasonable rate of return; or
- (2) the Covered Transaction has been designed to generate tax benefits that are disproportionate to the value actually received by ESOP participants.

Section IV. Conditions for Selling Shareholders

(a) Exercise of Authority.

No Selling Shareholder, relative or representative of a Selling Shareholder, or any person or entity under the control of a Selling Shareholder has or exercises any authority to:

- (1) participate in the ESOP's decisions or deliberations regarding:

- (A) whether to engage in the Covered Transaction;

- (B) negotiating the terms and conditions of the Covered Transaction or any loan or other extension of credit in connection with a Covered Transaction (an ESOP loan), including but not limited to the selection of the Independent Appraiser, the terms of the Independent Appraiser's engagement, and the determination of the Fair Market Value of the Employer Stock;

- (2) whether to hire or fire the Independent Trustee; or

- (3) whether to hire or fire the Independent Appraiser.

(b) Preservation of Independence.

Each Selling Shareholder takes steps prudently designed to ensure that:

- (1) no employee, executive, officer, or director of the Employer, or their representatives provides information to any Selling Shareholder or its representative about the ESOP's internal decisions, deliberations, work product, or analysis related to the Covered Transaction or ESOP loan, including but not limited to, any analysis or conclusions of the Independent Appraiser; and

(2) communications between each Selling Shareholder, its representatives, and the Independent Appraiser are monitored by the Independent Trustee, and that each Selling Shareholder and its representatives do not improperly influence the Independent Appraiser's analysis and conclusions, e.g., by suggesting or advocating to the Independent Appraiser for a particular determination as to the Fair Market Value for the Employer Stock.

(c) Loans with Employer.

If any Selling Shareholder enters into a loan or other extension of credit with the Employer in connection with a Covered Transaction, that loan or extension of credit must be on terms that are identical to the terms of any loan between the ESOP and the Employer in connection with the Covered Transaction.

(d) Accuracy of Information.

(1) No Selling Shareholder makes any material misrepresentations to the Independent Trustee or Independent Appraiser,

(2) Each Selling Shareholder takes steps prudently designed to ensure that the information provided to the Independent Trustee and Independent Appraiser is complete, current, and accurate.

(3) Each Selling Shareholder certifies in writing, without disclaimers or qualifications, that they have complied with paragraphs IV(a), (b), (c), and (d)(1), above, and that they are unaware of any material omissions or inaccuracies in the information provided to the Independent Trustee and Independent Appraiser.

(e) Special Rule for Selling Shareholders.

All Selling Shareholders may rely on this exemption if:

(1) each of the conditions set forth in sections III and IV(a), (b), (c), and (d) are satisfied;

(2) each Selling Shareholder and the ESOP receives the written certifications described in subsections (3)(A), (3)(B), and (3)(C), below, from the Monitoring Fiduciary, Independent Trustee, and Independent Appraiser, respectively,

(3) each Selling Shareholder neither knows nor reasonably should know that the certifications are false:

(A) *Monitoring Fiduciary Certification.* The Monitoring Fiduciary certifies in writing, without disclaimers or qualifications, that it:

(i) is relying on the terms of this exemption for relief from ERISA's prohibited transaction provisions;

(ii) has complied with the conditions set forth in section V of the exemption; and

(iii) is aware that the Selling Shareholders will rely on its certification in proceeding with the ESOP transaction.

(B) *Independent Trustee Certification.* The Independent Trustee certifies in writing, without disclaimers or qualifications, that it:

(i) is relying on the terms of this exemption for relief from ERISA's prohibited transaction provisions;

(ii) has complied with the conditions set forth in section VI of the exemption; and

(iii) is aware that the Selling Shareholders will rely on its certification in proceeding with the ESOP transaction.

(C) *Independent Appraiser Certification.* The Independent Appraiser certifies in writing, without disclaimers or qualifications, that it:

(i) has complied with the conditions set forth in section VII of the exemption; and

(ii) is aware that the Selling Shareholder will rely on its certification in proceeding with the ESOP transaction.

Section V. Conditions for Monitoring Fiduciary

(a) *Selection of Independent Trustee.*

(1) The Monitoring Fiduciary acts prudently and loyally, within the meaning of ERISA section 404, in investigating, selecting, and appointing the Independent Trustee to represent the ESOP with respect to the Covered Transaction.

(2) The Monitoring Fiduciary prudently determines that the Independent Trustee has sufficient financial resources to provide restitution to the plan for losses resulting from any breach by the Independent Trustee of its ERISA fiduciary obligations or the conditions of this exemption. In reaching this conclusion, the Monitoring Fiduciary may consider the amount of fiduciary liability insurance maintained by the Independent Trustee under section VI(d). The Monitoring Fiduciary may determine that fiduciary liability insurance is sufficient if it is available to cover losses equaling at least 20 percent of the purchase price. For purposes of this paragraph, losses include, but are not limited to, any overpayment by the ESOP for the purchase of Employer Stock (plus a reasonable rate of interest). The insurance may not contain an exclusion for actions brought under ERISA, including any brought by the Secretary of Labor, the ESOP, or plan participants or beneficiaries.

(b) Provision of Information.

The Monitoring Fiduciary:

(1) Prudently ensures that the Independent Trustee receives, in a timely fashion, complete, current, and accurate information concerning the Employer, its financial condition, as well as any other information that the Independent Trustee or Independent Appraiser requests to discharge its ERISA obligations of prudence and loyalty; and

(2) Makes available to the Independent Trustee for interview in connection with the Covered Transaction, any requested officer, employee, or contractor of the Employer within 10 business days after the Independent Trustee's request.

(c) Audited Financial Statements.

The Monitoring Fiduciary ensures that the Employer provides the Independent Trustee with audited, unqualified financial statements for the preceding five fiscal years that are prepared by a certified public accountant, or, if such statements are unavailable for the preceding five fiscal years, as far back as administratively feasible, but in all events such statements covering the preceding two fiscal years.

(d) Monitoring Fiduciary Oversight of Independent Trustee.

The Monitoring Fiduciary must have the authority to:

- (1) Replace the Independent Trustee if prudence requires replacement; and
- (2) Prevent the Covered Transaction from occurring if, at any time before or at the time of the Covered Transaction, the Monitoring Fiduciary knows or has reason to know that the Independent Trustee has failed to meet its responsibilities under ERISA, the Code, the conditions of this exemption, or its Independent Trustee Contract.

Section VI. Conditions for Independent Trustee

(a) Qualifications.

The Independent Trustee has appropriate technical training and proficiency with ERISA and the Code, specifically including expertise with respect to ESOPs and the methodologies used to determine the value of non-publicly traded stock.

(b) Conflicts of Interest.

(1) *General.* The Independent Trustee has no conflicts of interest with respect to the Covered Transaction that could affect the exercise of its best judgment as a fiduciary.

(2) *Conflicts of Interest – Prior Work.* Neither the Independent Trustee nor an Affiliate has:

(A) previously performed work for the Employer, any Affiliate, or a Selling Shareholder,

(B) conducted or participated in a feasibility study of the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder,

(C) prepared a preliminary stock valuation in connection with the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder, or

(D) otherwise performed preliminary work regarding the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder.

(3) *Conflicts of Interest – Compensation.* The Independent Trustee does not receive nor is expected to receive, any compensation, direct or indirect, from a Selling Shareholder; the Independent Trustee's compensation does not vary based upon its approval or disapproval of the stock purchase transaction; and the Independent Trustee does not receive compensation from the ESOP, the Employer and its Affiliates, and/or any person or entity assisting in structuring the Covered Transaction or providing advice or financial services in connection with the Covered Transaction that collectively exceeds two percent of the Independent Trustee's gross revenue for the Federal income tax year immediately preceding the year during which the compensation was received.

(c) Independent Trustee Contract.

The Independent Trustee enters into a written contract with the ESOP (the Independent Trustee Contract) that:

(1) Is executed before the performance of any work by the Independent Trustee;

(2) Contains an express acknowledgement by the Independent Trustee that the Independent Trustee is an ERISA fiduciary with respect to the ESOP for purposes of the Covered Transaction;

(3) Requires the Independent Trustee to ensure compliance with the exemption conditions applicable to the Independent Trustee at all times;

(4) Does not contractually waive any rights, claims, or remedies of the ESOP under ERISA, the Code, or State law against the Independent Trustee with respect to the Covered Transaction;

(5) Does not permit the Independent Trustee's compensation to vary based on the

price paid by the ESOP for the Employer Stock in the Covered Transaction, the structure of the Covered Transaction, or whether the Independent Trustee approves the Covered Transaction; and

(6)(A) Does not include any contractual provision that provides for the direct or indirect indemnification or reimbursement of the Independent Trustee by the ESOP, Employer, Selling Shareholder, or any Affiliates thereof for any violation of State or Federal law that may be attributable to the Independent Trustee's performance of its duties in connection with the Covered Transaction. In addition, no contract or instrument may purport to waive the Independent Trustee's liability for violations of any State or Federal law;

(B) Notwithstanding subsection (A), the Independent Trustee may receive a monetary advance from the Employer for the defense of any fiduciary breach claims if:

(i) the Independent Trustee agrees to pay back any funds it was advanced in a timely fashion with a reasonable rate of interest if the Independent Trustee is found liable in a court judgment for breach of its fiduciary duties in connection with the Covered Transaction or enters into a monetary or other settlement with respect to those breaches of fiduciary duty, and

(ii) the Independent Trustee posts adequate security for the funds that were advanced by the Employer.

(d) Insurance or Capitalization Requirement.

The Independent Trustee has sufficient financial resources to provide restitution to the plan for losses resulting from any breach by the Independent Trustee of its ERISA fiduciary obligations or the conditions of this exemption. In determining whether the Independent Trustee has sufficient financial resources, the Monitoring Fiduciary and Independent Trustee may consider the Independent Trustee's fiduciary liability insurance. Such insurance may be treated as sufficient if it is available to cover losses equaling at

least 20 percent of the purchase price. For purposes of this paragraph, losses include, but are not limited to, any overpayment by the ESOP for the purchase of Employer Stock (plus a reasonable rate of interest). The fiduciary liability insurance does not contain an exclusion for actions brought by the Secretary of Labor, the ESOP, or plan participants or beneficiaries.

(e) Preservation of Independence.

The Independent Trustee takes steps prudently designed to ensure that:

(1) no employee, executive, officer, or director of the Employer provides information to any Selling Shareholder or its representative about the ESOP's internal decisions, deliberations, or analysis related to the Covered Transaction or ESOP loan, including but not limited to, any analysis or conclusions of the Independent Appraiser;

(2) communications between the Selling Shareholders, their representatives, and the Independent Appraiser are monitored by the Independent Trustee; and

(3) the Selling Shareholders and their representatives do not improperly influence the Independent Appraiser's analysis and conclusions, e.g., by suggesting or advocating for a particular determination as to the Fair Market Value for the Employer Stock.

(f) Prudent and loyal selection of Independent Appraiser.

(1) The Independent Trustee has the sole fiduciary authority to engage an Independent Appraiser to value the Employer Stock. The Independent Trustee acts prudently and loyally, within the meaning of ERISA section 404, when investigating, selecting, and appointing an Independent Appraiser within the meaning of section I(f).

(2) *Written Analysis.* Before engaging an Independent Appraiser to determine the Fair Market Value for the Employer Stock, the Independent Trustee prepares a careful written analysis that sets forth:

(A) The reason for selecting the Independent Appraiser;

(B) A list of all of the appraisers that the Independent Trustee considered;

(C) A discussion of the qualifications of the appraisers that the Independent Trustee considered;

(D) A complete list of references that the Independent Trustee checked and a discussion of each reference's comments regarding the Independent Appraiser;

(E) A discussion of whether the Independent Appraiser has the requisite integrity to perform the engagement, as well as whether the Appraiser was the subject of prior criminal or civil proceedings;

(F) Verification that the Independent Appraiser does not have relationships with any parties to the transaction that might influence the Appraiser in the performance of the valuation; and

(G) A full explanation of the bases for concluding that the Independent Trustee's selection of the Independent Appraiser was prudent within the meaning of ERISA section 404.

(g) Independent Trustee's Reliance on the Independent Appraiser's Report.

(1) *General.* The Independent Trustee does not cause or commit the ESOP to pay, directly or indirectly, more than Fair Market Value for the Employer Stock on the date of the Covered Transaction.

(2) *Prudence and Loyalty.* The Independent Trustee acts prudently and loyally, within the meaning of ERISA sections 404(a)(1)(A) and (B) to determine that the Independent Appraiser's report satisfies the requirements of section VII(d) of this exemption and that reliance on the Independent Appraiser's report is prudent and reasonably justified under the circumstances based on a careful consideration of the Covered Transaction. The Independent Trustee (not the Independent Appraiser) is solely responsible for determining the Fair Market Value of the Employer Securities and terms of the Covered Transaction, and for zealously negotiating over the terms, structure, and cost of the stock purchase with prudence and undivided loyalty to the ESOP, its

participants, and beneficiaries. Accordingly, before entering into the Covered Transaction, the Independent Trustee must act with prudence and undivided loyalty to the ESOP, its participants, and beneficiaries in each of the following:

(A) Reading and critically reviewing the valuation report and supporting documents.

(B) Understanding the report.

(C) Identifying, questioning, and evaluating the report's underlying assumptions (e.g., performance forecasts or projections); assessing the reasonableness of those assumptions and the sensitivity of the appraisal's conclusions to those assumptions; and, to the extent that any alternative assumptions are reasonably plausible, assessing the potential impact of reasonable changes in the assumptions on the valuation's conclusions (e.g., the impact of variations in forecasts or projections), and the need for adjustments to the assumptions. For example, the Independent Trustee must prudently assess the reliability and trustworthiness of any projections of future performance, consider the likely consequence of missed projections, and ensure that the appraisal is based upon reliable and trustworthy projections.

(D) Verifying that the analyses in the valuation report are consistent with the application of sound valuation and financial principles, reflect an accurate assessment of the company's current financial condition and prospects, and that the report is internally consistent, well-reasoned, and consistent with available data.

(E) Verifying that the report is based on complete, current, and accurate financial information about the Employer.

(F) Ensuring that the report properly accounts for the impact of the grant or assignment of any interests, rights, or claims to potential income streams or corporate assets to parties other than the plan shareholder.

(G) Ensuring that any adjustment to value based on a controlling or non-controlling interest is consistent with the circumstances surrounding the transaction, including the degree of control that the plan will have after the transaction and its ability to use that control to affect the stock's value. An ESOP may only pay a sales price based on obtaining a controlling interest where, based on the facts and circumstances, actual control (both in form and substance) is passed to the ESOP purchaser with the sale and the ESOP has the means to effectuate changes to enhance value. Before an Independent Trustee agrees to a fair market value based on obtaining a controlling interest the Independent Trustee must be able to identify the source of the incremental value and its basis for concluding that the ESOP can be expected to realize that value. If, for example, the relevant transaction and governance documents establish that the plan will not have meaningful control over the actions of the corporation post-acquisition, it should not pay a premium for control.

(H) Ensuring that the reported value reflects an appropriate discount for lack of marketability, and prudently justifies the discount selected.

(I) Ensuring that the report and the transaction are free from bias or undue influence by any counterparty.

(J) Ensuring that the projected return on the ESOP's price per share over an appropriate period is consistent with the rates of return demanded by equity investors in similar transactions and is commensurate with the risks associated with the stock purchase.

(K) Ensuring that the report reflects the prudent consideration of the Employer's ability to meet any stock repurchase obligations, comply with its contribution obligations, and meet any debt, direct or indirect, or other obligations established in connection with the transaction.

(L) Representing the interests of the ESOP in negotiations on the terms of the

Covered Transaction, ESOP loan, and Fair Market Value of the Employer Stock without regard to the interests of any party other than the ESOP, its participants, and beneficiaries, and entering into the Covered Transaction only if it is in the interest of the ESOP, its participants, and beneficiaries.

(M) Concluding, based on its critical review of the Independent Appraiser's report and all material facts, that the ESOP will pay no more than Fair Market Value for Employer Stock as of the date of the Covered Transaction.

(3) *Fiduciary Review Process – Documentation of Internal Deliberation.* The Independent Trustee documents:

(A) The identities of the Independent Trustee's personnel who were primarily responsible for engaging in the Covered Transaction, including any person who participated in the decision on whether to proceed with the Covered Transaction or the Fair Market Value for the Employer Stock;

(B) Any deliberations concerning the Independent Trustee's approval of the Covered Transaction or the conclusions and analysis set forth in the report;

(C) Any material points as to which the Independent Trustee's personnel disagreed and the substance of the disagreements; and

(D) Any concerns expressed by the Independent Trustee's personnel regarding the reliability of the Independent Appraiser's report, its conclusions, or analysis.

(h) Dividends.

The Independent Trustee prudently ensures that any dividends on the Employer Stock acquired by the ESOP are reasonably expected to be paid to the ESOP for ultimate allocation to participant accounts, and not to repay any debt incurred by the ESOP in connection with the Covered Transaction or to defray Employer contributions to the ESOP.

Section VII. Conditions for Independent Appraiser.

(a) Qualifications.

The Independent Appraiser has appropriate technical training and proficiency with respect to the valuation of non-publicly traded stock and any other analyses required by the Independent Trustee and is subject to appropriate professional standards in performing the valuation services.

(b) Conflicts of Interest.

(1) *General.* The Independent Appraiser has no conflicts of interest that could impair its judgment regarding any aspect of the Covered Transaction.

(2) *Conflicts of Interest – Prior Work.* Neither the Independent Appraiser nor an Affiliate of the Independent Appraiser has previously performed work for or on behalf of the Employer, any Affiliate, or a Selling Shareholder, particularly including, but not limited to (i) conducting or participating in a feasibility study of the Covered Transaction, (ii) preparing a preliminary stock valuation in connection with the Covered Transaction, or (iii) otherwise performing preliminary work regarding the Covered Transaction on behalf of the Employer, any Affiliate, or a Selling Shareholder. Also, the Independent Appraiser must not have recommended or referred, or been recommended or referred by, the Independent Trustee to the Employer, any Affiliate, a Selling Shareholder, or any fiduciary of the ESOP to perform work in connection with the Covered Transaction.

(3) *Conflicts of Interest – Compensation.* The Independent Appraiser does not receive, and is not expected to receive, any compensation, direct or indirect, from a Selling Shareholder; the Independent Appraiser's compensation does not vary based on the price paid by the ESOP for the Employer Stock in the Covered Transaction, the structure of the Covered Transaction, or whether the Covered Transaction is consummated; and the Independent Appraiser does not receive compensation, direct or indirect, from the ESOP, the Employer and its Affiliates, and/or any person or entity

assisting in structuring the Covered Transaction or providing advice or financial services to the Employer or a Selling Shareholder in connection with the Covered Transaction, that collectively exceeds two percent of the Independent Appraiser's gross revenue for the Federal income tax year immediately preceding the year during which the compensation was received.

(4) *Conflicts of Interest – Reporting.* The Independent Appraiser does not take direction from or share its analysis or conclusions regarding any aspect of the Covered Transaction with any party other than the Independent Trustee.

(c) *Independent Appraiser Contract.*

The Independent Trustee enters into a written contract with the Independent Appraiser before the Independent Appraiser performs any work on behalf of the ESOP, and the contract:

(1) Sets forth the duties of the Independent Appraiser;

(2) Requires the Independent Appraiser to comply with the exemption conditions applicable to the Independent Appraiser; and

(3)(A) Does not contractually waive any rights, claims, or remedies of the Independent Trustee or the ESOP under ERISA, the Code, or State law against the Independent Appraiser with respect to the Covered Transaction or the quality of the Independent Appraiser's work; this limitation also prohibits any contractual indemnifications or caps on liability for violations of State or Federal law.

(B) No party related to the Employer, Selling Shareholder, or Plan has or will indemnify the Independent Appraiser for any violation of State or Federal law that may be attributable to the Independent Appraiser's performance of its duties in connection with the Covered Transaction. In addition, no contract or instrument may purport to waive the Independent Appraiser's liability under any State or Federal law for any such violations.

(C) Does not disclaim liability, through contractual limitations, indemnities, or otherwise, if it fails to perform valuation services in accordance with professional standards, such as by limiting its liability for negligent work.

(d) Independent Appraiser's Report.

(1) The Independent Appraiser prepares a written report that:

(A) sets forth the Fair Market Value for the Employer Stock;

(B) analyzes whether the Covered Transaction is financially fair and in the best interest of the ESOP;

(C) assesses the impact of the Covered Transaction on the financial viability of the Employer; and

(D) examines the ability of the Employer to service any debt obligations, including but not limited to, obligations incurred in connection with the Covered Transaction.

(2) The Independent Appraiser certifies in writing that the opinions and analyses set forth in the written report:

(A) are based on complete, current, and accurate data,

(B) are consistent with that data, adhere to standards that an expert in like capacity and familiar with such matters would use when creating the written report, and

(C) reflect the reasonable exercise of professional judgment without bias in favor of the Selling Shareholders.

(3) The Independent Appraiser's written report specifically includes, but is not limited to, the following elements and analyses prepared in accordance with the standards set forth in paragraph (d)(2):

(A) the identity of the individuals responsible for providing current financial data and projections of future economic performance of the Employer that are reflected in the report, and as to those individuals, the results of a reasonable inquiry as to:

(i) whether those individuals have or reasonably may be determined to have any conflicts of interest in regard to the ESOP or the Employer Stock price;

(ii) whether those individuals serve as agents or employees of persons with such conflicts;

(iii) the precise nature of any such conflicts; and

(iv) a written record of how the Independent Appraiser considered such conflicts in determining the Fair Market Value for the Employer Stock;

(B) analysis of the Employer's material strengths and weaknesses, which may include, as appropriate, strengths and weaknesses relating to personnel, plant and equipment, capacity, research and development, marketing strategy, business planning, financial condition, and any other factors that reasonably could be expected to affect future performance and the Fair Market Value for the Employer Stock;

(C) the Independent Appraiser's reasonable professional opinion regarding the reliability and reasonableness of any projections considered in connection with the Covered Transaction and an explanation of why and to what extent the projections are reasonable or unreasonable. At a minimum, the analysis considers:

(i) how the projections compare to, and whether they are reasonable in light of, the Employer's five-year historical averages and/or medians and the five-year historical averages and/or medians of a group of comparable public companies (if any exist) for the following metrics, unless five-year data are unavailable (in which case, the analyses will use averages extending as far back as possible); and

(ii) return on assets, return on equity, EBIT (Earnings Before Interest and Taxes) margins, EBITDA (Earnings Before Interest, Taxes, Depreciation, and Amortization)

margins, ratio of capital expenditures to sales, revenue growth rate, and ratio of free cash flows (of the enterprise) to sales;

(D) If the Independent Appraiser determines that any of the preceding metrics should be disregarded, documentation of the calculations of the metrics (unless calculation is impossible) and the reasonable basis for its conclusion that the metrics should be disregarded. The use of additional metrics to evaluate the reasonableness of projections other than those listed above is not precluded as long as the appropriateness of the metrics is documented;

(E) If the Employer is projected to meet or exceed its unadjusted historical performance or the unadjusted historical or expected performance of the group of comparable public companies on any of the metrics described above, documentation of all material assumptions supporting the projections and why those assumptions are reasonable;

(F) All adjustments to the Employer's historical or projected financial data, statements, attributes, or performance metrics, including documentation of the adjustments and an explanation of why the adjustments would be accepted by a prudent long-term third-party financial investor in an arm's length transaction;

(G) The specific discount rate(s) applied in connection with any analysis based on discounted cash flows, including whether any weighted average cost of capital used by the Independent Appraiser was based on the Employer's actual capital structure or that of a relevant industry, and an explanation of the systematic and unsystematic risks of the Employer along with why the particular discount rate(s) and capital structure weighting were reasonable;

(H) An explanation of any apparent inconsistencies between the general economic and industry-specific narrative in the valuation report with the quantitative aspects of the report;

(I) If other companies are relied upon as comparable companies for any part of a valuation of the Employer Stock, whether as part of a guideline public company method of valuation to gauge reasonableness of projections, or for any other purpose, a written explanation of the bases for concluding that the companies are actually comparable to the Employer, including on the basis of industry, size, customer concentration (if such information is publicly available), and volatility of earnings, and access to the capital markets. If a guideline public company analysis is performed, a written explanation of any discounts applied to the multiples selected, and if no discount is applied to any given multiple, a detailed written explanation of the reasons a discount was not applied;

(J) If greater weight is assigned to some valuation methods over others, an explanation of the weighting assigned to each valuation method and the basis for the weightings assigned;

(K) Analysis and documentation of the appropriate marketability discount for the Employer Stock, and an explanation of why a prudent long-term third-party financial investor in an arm's length transaction would accept the discount as appropriate;

(L) Analysis of how the ESOP's plan document provisions regarding stock distributions, the duration of the ESOP loan, the use of contributions and dividends paid, and the age and tenure of the ESOP participants, may affect the ability of the Employer to meet prospective repurchase obligations, the prudence of the stock purchase, and the Fair Market Value for the Employer Stock;

(M) Analysis and documentation of the financial impact of the Covered Transaction on the Employer, and written documentation of the factors considered in such analysis and conclusions, and:

(i) the extent to which the Employer would be able to service any debt incurred in connection with the Covered Transaction (including the ability to service the debt in the event the Employer fails to meet the projections relied upon in valuing the stock);

(ii) whether the Covered Transaction is fair to the ESOP relative to all other parties to the Covered Transaction; and

(iii) whether the terms of the Covered Transaction financing are market-based, commercially reasonable, and in the best financial interests of the ESOP;

(N) Specific downward adjustments to the appraised Fair Market Value for the Employer Stock to reflect the dilutive impact of any outstanding Employer Stock or other interest at the time of the Covered Transaction or that is expected to be issued, awarded, or granted;

(O) As applicable, the rationale for valuing the Employer Stock on a controlling basis, or a minority basis, and for concluding that a prudent long-term third-party financial investor in an arm's length transaction in the ESOP's position would purchase the stock on that basis. The report must specifically discuss any limitations on the exercise of operational control by the ESOP; and in determining Fair Market Value for the Employer Stock, the appraiser may not value the stock to reflect a degree of control that the ESOP is not reasonably expected to obtain;

(P) Analysis of any material assumptions underlying the report's key conclusions, including its conclusions as to Fair Market Value for the Employer Stock, projections of future financial performance, the reasonableness of any debt obligations incurred by the ESOP or Employer in connection with the transaction, and the fairness of the transaction to the ESOP;

(Q) Analysis of the sensitivity of the appraisal's conclusions to the material assumptions identified in the preceding paragraph, the likelihood that the assumptions will prove materially correct, and the potential impact of reasonably likely alternative assumptions or reasonable adjustments to those assumptions on the appraisal's key conclusions. The written report must specifically state if any reasonably likely alternative assumptions could result in the failure of the Employer or in its inability to meet its

financial obligations to the ESOP or its creditors, and how that risk has been specifically factored into the Independent Appraiser's conclusions;

(R) The Independent Appraiser's determination that any debt obligations incurred by the ESOP or Employer in connection with the Covered Transaction are commercially reasonable and that interest rates are not in excess of reasonable rates, and an explanation of the bases for these conclusions, including a comparison of those rates with commercially available rates for comparable loans, if any, and with the rates actually offered to the Employer from a conventional lender for comparable loans, if any; and

(S) Analysis of any other indications of value for the Employer or the Employer Stock existing for the 12-month period preceding the Appraisal Report, including offers and negotiations to purchase the Employer or Employer Stock, completed sales of Employer Stock, or valuations performed for any purpose. The analysis should describe what information and data the Independent Trustee or Independent Appraiser requested to determine the indications of value that existed and how those indications of value were incorporated into the appraisal's conclusion of value. If they were not incorporated, the analysis shall explain why the values were not incorporated.

Section VIII. Recordkeeping

(a) Record Maintenance.

The Independent Trustee maintains the records necessary to enable the persons described in paragraph (b) of this section to determine whether the conditions of this exemption have been met with respect to a Covered Transaction for a period of six years in a manner that is reasonably accessible for examination, and must provide these records to the Department's Office of Exemption Determinations within 30 days from the date of the Department's request, except that:

(1) If such records are lost or destroyed, due to circumstances beyond the control of the respective party, then no prohibited transaction will be considered to have occurred

solely on the basis of the unavailability of those records; and

(2) No party, other than the party responsible for complying with this paragraph, will be subject to the civil penalty that may be assessed under ERISA section 502(i) or the taxes imposed by Code section 4975(a) and (b), if applicable, if the records are not maintained or are not available for examination as required by paragraph (b) of this section.

(b) Availability.

(1) Except as provided in paragraph (b)(2) of this section or precluded by 12 U.S.C. 484 and notwithstanding any provisions of ERISA section 504(a)(2) and (b), the records referred to in paragraph (a) of this section are reasonably available at their customary location for examination during normal business hours by:

(A) Any authorized employee or representative of the Department or the Department of Treasury, including the Internal Revenue Service;

(B) Any fiduciary of an ESOP that engaged in a Covered Transaction pursuant to this exemption, or any authorized employee or representative of such fiduciary;

(C) Any employee organization whose members are covered by an ESOP described in paragraph (b)(1)(B), or any authorized employee or representative of the employee organization; or

(D) Any participant or beneficiary of an ESOP described in paragraph (b)(1)(B) or the authorized representative of such participant or beneficiary; and

(2) None of the persons described in paragraph (b)(1)(B) through (D) of this section are authorized to examine records regarding a Covered Transaction involving privileged trade secrets or privileged commercial or financial information of the Employer, Independent Trustee, or Independent Appraiser, or information identifying other individuals.

(3) If the Independent Trustee refuses to disclose information pursuant to the

preceding paragraph on the basis that the information is exempt from disclosure, the party must, by the close of the thirtieth (30th) day following the request, provide a written notice advising the requestor of the reasons for the refusal and that the Department may request such information.

(4) Failure to maintain the required records necessary to determine whether the conditions of this exemption have been met will result in the loss of the exemption only for the Covered Transaction for which records are missing or have not been maintained. The failure to maintain records for a Covered Transaction does not affect the relief for other Covered Transactions for which such required records are maintained.

Signed at Washington, DC, this 13th day of January 2025.

Lisa M. Gomez,

*Assistant Secretary,
Employee Benefits Security Administration, U.S. Department of Labor.*

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