Session Introduction

The objectives of this session are:

- Overview of your duties and responsibilities as an ESOP Trustee
- Discuss practical situations and “best practices”
- Share experiences
Trustees Come in Different Forms

Individual Internal Trustees
- Frequently officers/employees of the Company
- Pros and Cons

Independent Trustees
- Could be an independent individual, however, Institutions usually fill this role (banks, trust companies, etc.)
- Limited transactional vs. ongoing
- Pros and Cons

Directed Trustees
- Receives direction from insider fiduciaries or independent fiduciaries

Similarities and Differences
- Responsibilities
- Risks
- Judicial deference

Duties and responsibilities of the “Fiduciary” are defined in Plan and Trust documents

Who is an ERISA Fiduciary

Anyone who has discretion or control over Plan Assets:
- Plan Sponsor/Board of directors: appoint/remove other fiduciaries; oversight
- Trustee (directed or discretionary): Record owner of shares held by ESOP; acts for “exclusive benefit” of participants; votes shares (but may be directed)
- ESOP Committee (if any): interprets plan; reviews claim appeals; may vote shares; may be Plan Administrator also
- Valuation Firm: annually appraises ESOP shares; may perform valuation of, or financial advisory service for, specific transactions? (Are they a “fiduciary”)
What Are the Legal Aspects of Being an ESOP Trustee?

A Fiduciary must:
- Discharge duties solely in the interests of the Plan Participants
- Discharge duties with care, skill, prudence and diligence
  - Under the circumstances then prevailing
  - That a prudent person acting in a like capacity and familiar with such matters would use
  - In the conduct of an enterprise of a like character and with like aims
- Act in accordance with plan documents
  - Insofar as such documents are consistent with ERISA and other applicable law
- Steer clear of prohibited transactions
  - Related-party sales
  - Loans

Duties of the Internal Trustee:

- Invest trust assets
- Retain independent, experienced valuation firm (and counsel for transactions)
- Determine value of company stock (discretionary)
- Maintain confidentiality of valuation reports
- Determine adequacy of funding for repurchase obligation (discretionary)
- Review annual allocation report
- Review annual Form 5500 (and, if applicable, audit)
- Perform distributions and tax reporting (usually directed)
- Vote Shares held within ESOP (usually directed)
- Employee communication and disclosures
National Wire & Cable

- Manufacturer of Custom Data Transmission and Control Cables and Connectorized Cable Assemblies
- Headquartered in Los Angeles and servicing both domestic and international customers since 1952
- 125 Employees
- ESOP established in 1988
- 95% ESOP Owned C-Corporation

Bob Sanchez

- Vice President and CFO
- Member of Board of Directors, Corporate Secretary and Member of ESOP Advisory Committee
- 15 Years with National Wire & Cable
- Responsible for financial and tax planning and reporting, accounting and risk management
- ESOP – Coordinate all work between Directed Trustees, CPA, Legal Counsel, Valuator and Third Party Administrators
Practical Applications of the Trustees
Responsibilities

I. Valuation

- Determining Value/Stock Price – The Trustee is responsible.
- What should the Trustee do with the valuation report?
- Process for accepting the report from valuation firm
  - Is appraiser independent?
  - Review the report
  - Ask questions
    - Review the approaches
    - Unique circumstances
    - Have questions been answered and documented

Other Valuation-related Information that the Trustee should Consider:

- Overall solvency of the Company
- Necessity of the Trustee to discuss issues with management
- Repurchase Liability
- Challenges and limitations of an internal Trustee
Trustee Responsibilities

II. Stock Purchase

• Prudence and the exclusive benefit rule
• Is the purchase a prohibited transaction
• Conduct Due-Diligence Investigation
  • Financial matters (Adequate Consideration)
  • Legal matters
  • Consider impact on existing shares held by the ESOP
• Negotiate Price
• Documentation
• Role of Conflicts

Conflicts of Interest

• Officers or directors of employer may serve as trustee, “Plan Administrator,” or ESOP committee member
• State law duty to company and all shareholders as officer/director, but ERISA’s federal law fiduciary duty (which preempts state law) is “solely” to and for participants
• General: ESOP’s interests may conflict with management’s
• Solution for conflict – “special fiduciary” or independent trustee

Which hat is on?

• When a Company Executive or Owner is also the Internal fiduciary, there may be a conflict (duty to stockholders v. duty to plan participants).
  THINK:
  In what capacity am I acting in making this decision?
III. Voting

- Trustee Votes
  - Is the Trustee directed?
  - Investigation and documentation
- Pass-Through Vote to Participants
  - Merger, consolidation, liquidation, sale of substantially all company assets, “organic changes”
  - Voluntary Voting for Board of Directors
  - Adequacy of information provided to participants
- Ensure Voting Safeguards, confidentiality
- Role of Conflicts
  - Voting for yourself
  - Should you abstain?

IV. Recordkeeping and Day-to-Day Trust Accounting

- Payment of the ESOP loan
  - Notify the Company of pending loan payments due
  - Collect the loan payments from the company and make the necessary payments to the bank or bank to the company
    - All loan payments need to be run through the trust even if the loan is from the company
    - Working with TPA, calculate the release of the shares as per the loan documents and make sure that all covenants have not been violated
Miscellaneous Recordkeeping/Trust Accounting:

- Maintain Trust Checking Account
- Retain and Maintain Custody of ESOP Stock Certificates
- Submit Annual Report and Accounting to Company

Allocations:

- The trustee serves for the exclusive benefit of the participants and their beneficiaries. The Trustee should check the Allocation Reports to insure that they are correct.
  - Verify the release of shares
  - Spot check the allocations
  - Verify the number of shares on the reports to the Trust
  - Statements for both the allocated and unallocated shares
- Look at the results of the 409(p) test for Sub S ESOPS. Is there a non-allocation year?
Distributions:

- The Trustee makes the distributions to the plan participants as directed by the Plan Administrator.
- The distributions should be verified to the allocation reports before checks are issued.
- Prepare the check or stock certificates (if shares are to be paid out).
- Compute income tax withholding. Prepare the appropriate tax reporting forms and send withholding timely to the IRS.

ESOP Stock Recycling vs. Corporate Stock Repurchase

- If the Company purchases distributed ESOP shares, is it a Fiduciary decision?
- If the ESOP purchases distributed ESOP shares, is it a Fiduciary decision?
- What if Company offers to repurchase ESOP shares from the ESOP so that the ESOP can distribute cash in lieu of shares?
  - If stock is sold by the ESOP to the Company, the sale is a party-in-interest transaction and must be done at a fair market value as determined at time of the sale, not as of last annual valuation date.
Trustee Responsibilities

V. Non-Routine Events

- Sale of Company
  - Asset sale or merger
  - Stock sale
  - Refinancing of ESOP loan balance(s)
- Increasing or decreasing the ESOP’s ownership
- Corporate transactions that offset stock value
  - Executive compensation
  - Acquisitions of other companies

Trustee Responsibilities

- Monitoring
- Board Meetings
- Shareholder Meetings and Voting
- Repurchase Liability
- Extraordinary Transactions
Liability for Breach of Duty

- Liability for Breach of Duty
- ERISA Section 409(a)
- Penalties for Violation of Prohibited Transaction Rules
- Indemnification
- Liability for Breach of a Co-Fiduciary

Indemnification Issues

- Review indemnification agreements
- Review level of ERISA fiduciary liability coverage for adequacy; take defense costs into account
- Board of Directors – annual review of actions of ESOP Trustee (including stock valuations); seek independent, competent advice of executive compensation and board fees
Thank You

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