

January 19, 2011

United States Department of Labor  
Employee Benefits Security Administration  
Washington, D.C.

**RE: Response to Proposed Rule Regarding ERISA “Fiduciaries” (29 CFR Part 2510)**

The Department of Labor (“DOL”) recently proposed new regulation (29 CFR 2510 or the “Proposed Regulation”) more broadly defines the circumstances under which a person is considered to be a “fiduciary.” This correspondence addresses the Proposed Regulation that is aimed at Appraisals and Valuation Opinions regarding Employee Stock Ownership Plans (ESOP). The intent of the Proposed Regulation is to expand the definition of who is a fiduciary to all stock appraisers and authors of fairness opinions relating to ESOP stock acquisitions.

Enterprise Services, Inc. (ESI) is a business valuation consulting firm that has a significant ESOP client base. This Proposed Regulation will have a decidedly negative impact on ESOPs in closely held companies for the following reasons.

Negative Development 1. The current law regarding the valuation of stock in a private company for the purposes of an ESOP requires an “independent” appraiser, 26 U.S. Tax Code 401(a)(28)(C). There are many years of precedence underlying this position, and this is the accepted requirement of valuation within the ESOP community, Internal Revenue Service (IRS) and the Department of Labor.

If the Proposed Regulation is finalized the stock appraiser will become a plan fiduciary. In such circumstances, how can the appraiser retain independence? As a fiduciary to the ESOP, the appraiser will have the regulatory responsibilities such as acting solely in the exclusive best interests of the ESOP participants, and to have undivided loyalty to the plan. Such fiduciary responsibilities are inherently contradictory to the requirement of independence for the ESOP valuation. This Proposed Regulation places the appraiser in highly conflicted circumstances. With such comprehensive fiduciary loyalty to the ESOP, few if any rational business owners would find the valuation analysis of a fiduciary appraiser credible. This conflict will significantly diminish the interest in ESOPs by business owners.

Assuming the appraiser is designated as a fiduciary; many business owners will be suspicious and question the objectivity of that appraiser prompting a serious consideration for another

valuation that is actually “independent” or objective. This type of mental gymnastics will slow down the process, increase costs substantially (a second valuation and costs to the fiduciary appraiser for things like insurance and additional due diligence), and be a decided negative development to owners of private companies.

Negative Development 2. The DOL purports to hold appraisers more fully accountable as a fiduciary with the Proposed Regulation. This goal is seriously compromised by the failure of the DOL to issue clear valuation standards for ESOPs. The DOL has issued proposed regulations as it relates to a definition of adequate consideration (29 CFR Part 2510 Regulation Relating to the Definition of Adequate Consideration, Notice of Proposed Rulemaking, 1988). The adequate consideration proposed regulations have never been finalized. Indeed, these proposed regulations dating back to 1988 also stipulate an independent valuation is required for an ESOP. We question how it is possible to define the responsibilities of a fiduciary without defining what are the standards of conduct with regard to the appraisal of the stock?

Negative Development 3. Naming the appraiser as a fiduciary will only invite considerable confusion within the industry. There will be a Trustee with fiduciary responsibilities at the ESOP company at a minimum (and perhaps an outside Trustee as well), in addition to the appraiser as a fiduciary. This “co-fiduciary” scenario will result in a poor understanding and confusion of where the responsibility rests in determining the value of the stock along with all of the other fiduciary responsibilities (e.g. compliance with ESOP documents, record keeping, investments, etc.). This will almost certainly create an environment of uncertainty that only the Federal Courts will be able to unravel. This opaque intrusion into the already clearly established lines of fiduciary responsibility will be a decided negative for owners of private companies thinking of an ESOP, and existing ESOP companies.

Rather than having the ESOP as a desirable solution for succession planning, the entire process will be blurred with professional service providers trying to decide who is responsible for the valuation and the full range of other fiduciary responsibilities. The certain result will be parties mired down in a never ending conflict over such matters as the language in engagement letters trying to define responsibilities, indemnification provisions, and resolving conflicts of interest. If decisions about co-fiduciary responsibility are left to the Federal Courts and lawyers, there will be an increasing number of valuation practitioners that will avoid the uncertainty and refuse ESOP valuations.

Negative Development 4. As a result of the confusion, misguided regulatory complexity and uncertainty created by the Proposed Regulation, there will be fewer appraisers willing to provide ESOP valuations. This will reduce the number of possible appraisal service providers.

Those that continue to provide the appraisal service will be faced with markedly higher costs and liability exposure for such things as fiduciary insurance (if available) and additional due diligence. Higher costs will be a significant impediment to smaller companies wishing to embrace the vision of employee ownership with the foreseeable result there will be fewer ESOPs in private companies.

Negative Development 5. Appraisal firms frequently have multiple associates working on the appraisal assignments. Most current business valuation standards require that all individuals at the appraiser having significant input into the valuation be identified or sign the report. Does the Proposed Regulation definition of being a fiduciary extend to all staff members having input into the appraisal? The unlimited personal liability attached to being a fiduciary along with the other fiduciary duties mentioned previously will have a pronounced chilling effect on anyone thinking of providing ESOP valuations. This uncertainty will drive appraisers from the ESOP valuation market, and those that remain will raise prices significantly to cover this exposure. No other business valuation imposes such onerous unlimited personal liability restrictions. The clearly foreseeable result is that fewer appraisal firms will consider doing ESOP assignments, and the remaining firms will have to raise fees substantially to cover unknown costs and the unlimited personal liability.

### **Options to the Proposed Regulation**

The Proposed Regulation is a reaction to largely a single problem the DOL has identified (faulty ESOP appraisals) without quantifying the nature or the amount of harm that has been caused. Rather than defining the appraiser as a fiduciary with all the negative results and problems that will occur as discussed in this letter, the DOL has several other viable solutions to the perceived problem. Alternative solutions could be explored that are both cost effective and will not result in the harm that the Proposed Regulation will bring.

Proposed Alternative Solution 1. The DOL could insist on appraiser standards similar to what the IRS has done with gift tax returns. The IRS has recently instituted appropriate regulations stating that only a “qualified appraiser” may complete the gift tax return. A qualified appraiser in this context is defined by the IRS as an individual that has met exacting educational standards, earned an appropriate appraisal designation from a recognized appraisal organization, and has the requisite experience to provide the analysis among other requirements. The benefit of placing such a requirement on the appraiser is that such work will be subject to worthwhile objectives as: ethical standards, rigorous training, continuous learning, appraiser penalties, and recourse if the standards are not maintained. The private sector strives to build professionalism within the valuation accreditation organizations. Having the support of the Federal government where there is a vested interest in accurate appraisals

would be most helpful. Offering specific guidance on ESOP valuations will also help the appraisers comply with the existing regulations.

Proposed Alternative Solution 2. Require standards for the ESOP Trustee that must be acknowledged as being understood and in writing by the individual. Specifically, those standards as they relate to an ESOP should include an understanding of the appraisal. Currently anyone may serve as an ESOP Trustee with no training, experience or educational requirements. Holding a Trustee accountable to fiduciary standards and insuring they understand such standards will help solve the problem of flawed appraisals.

### **Summary**

As defined and currently written, the Proposed Regulation will be a very negative development regarding ESOPs in privately held companies. The Proposed Regulation will foster uncertainty among service providers, increase costs to business owners thinking of an ESOP, and further fuel the impression that ESOPs are needlessly complex and not encouraged by the Federal Government. The Proposed Regulation will have a particularly negative impact on smaller private companies that will not be able to afford the professional fees or tolerate the needless complexity of completing transactions. The predictable result will be substantially diminished interest in ESOPs in private companies.

For the many reasons cited in this letter, the Proposed Regulation will have a decidedly harmful impact on existing ESOPs and on business owners in private companies considering an ESOP. The DOL is taking a position contrary to existing law that encourages the creation of ESOPs (P.L. 94-455, 90 Stat. 1520).

There are better options for the DOL to consider regarding the issue of incorrect ESOP valuations of stock in private companies. Those options will not discourage the formation of ESOPs in private companies that have accomplished so much in providing a doorway for so many to become successful and significant participants in our market based economy.

Sincerely,

ENTERPRISE SERVICES, INC.



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President