KEGLER BROWN HILL & RITTER
A LEGAL PROFESSIONAL ASSOCIATION

January 28, 2011

Mr. Fred Wong
Office of Regulations and Interpretations
Employee Benefit Security Administration
U.S. Department of Labor
Room N-5655
200 Constitution Avenue
Washington, DC 20210

R.E.: Definition of Fiduciary Proposed Rule

This letter is in response to the U.S. Department of Labor ("DOL") proposed rule (the "Proposed Rule") issued on October 21, 2010, as to the definition of a fiduciary under Section 3(21)(A) of the Employee Retirement Income Security Act ("ERISA"). The Proposed Rule, if it becomes final, would expand the meaning of "investment advice" for a fee to include "advice, or an appraisal or fairness opinion, concerning the value of securities" with respect to an ERISA plan. This letter will be limited to the effect of the Proposed Rule upon employee stock ownership plans ("ESOPs") as defined in Section 4975(e)(7) of the Internal Revenue Code (the "Code").

1. Legal Issues. We note a number of apparent problems with the Proposed Rule under current statutory law, regulations and case law, including the following:

.a. Code Section 401(a)(28)(C) which requires employer securities in an ESOP to be valued by an independent appraiser which could be precluded to the extent that the appraiser and the trustee of the ESOP are co-fiduciaries.

.b. Impairment of or inconsistency with the "prudent expert" standard of fiduciary duty imposed upon ESOP trustees relating to the valuation of and transactions involving sponsor employer securities under *Reich v. Valley National Bank of Arizona, 837 F.Supp 1259 (NY, 1993).* (aka, the "*Kroy*" case).

.c. A certain 1976 DOL advisory opinion stating that "investment advice" does not include a valuation of stock that an ESOP would rely on to the purchase stock.

2. Existing DOL Remedies. We note, from personal experience, that DOL has neither been diligent nor consistent in utilizing existing remedies with respect to the "*faulty valuations*" cited in the Proposed Rule with respect to ESOP appraisals and opinions.

.a. Two leveraged ESOP transactions involving the same company wherein DOL, after correctly concluding upon audit that both were prohibited transactions involving millions of dollars, nevertheless declined to recover any of the ill-gotten gains from the seller/trustee. Both transactions were based upon valuations prepared by a major ESOP valuation firm.

.b. Two non-leveraged ESOP transactions involving the same company wherein DOL, after correctly concluding upon audit that both were prohibited transactions, declined to hold the former trustee accountable because the former trustee refused to sign a tolling agreement.

.c. Upon audit by DOL, no comment as to the valuation of an ESOP company valued in the multi-millions of dollars using industry rule-of-thumb methods with a statement in valuation that the DOL proposed valuation regulations were not used because a copy "was not provided" to the valuator.

.d. Upon audit by DOL, no comment as to the valuation of an S corporation ESOP company for a leveraged transaction wherein the valuator stated that federal income tax normalization (i.e., imputing federal income taxes) was not appropriate for an ESOP valuation.

.e. Upon audit by DOL, no comment as to the valuation of a leveraged ESOP company wherein the valuator included in equity value the ESOP loan tax shield (i.e, tax savings for deduction of contributions applied to ESOP loan principal) for the entire 10 year term of the ESOP loan.

3. Recommendations. We acknowledge, from personal experience and case law, that problems exist with respect to ESOP appraisals and opinions. Rather than impair existing statutory law, existing regulation and existing case law, as would be likely under the Proposed Rule, we suggest the following:

.a. Finalize the DOL regulation for ESOP valuations issued in 1987 as Proposed Regulation 2510.3-18(b). Revise the Regulation to affirm the prudent expert duty of ESOP trustees under the *Kroy* case with respect to appraisals and transactions involving employer securities and to address the major issues associated with the "*faulty valuations*" cited in the Proposed Rule.

.b. Include within final Regulation 2510.3-18(b), a provision relating to the professional standards and certifications that must apply to persons providing appraisals and opinions with respect to an ESOP in general and to leveraged ESOPs in particular.

.c. Revise the Proposed Rule by replacing its existing language with a requirement that any leveraged ESOP transaction must be approved by an independent outside fiduciary and that any ESOP with majority ownership of the sponsor company must have independent outside fiduciary. Such fiduciary could be the trustee, the named fiduciary or, for the purpose of a leveraged transaction, a special fiduciary. De minimis and hardship exemptions could also be included.

.d. Further revise the Proposed Rule by including guidance for a "safe harbor" ESOP that incorporates the issues of major importance to DOL including, but not limited to, valuations,

qualification of ESOP fiduciaries, indemnification of ESOP fiduciaries, corporate governance and ESOP investment policy.

.e. Improve the level of training of DOL auditors involved in the audit of ESOPs and, in particular, with respect to valuations and leveraged ESOP transactions.

.f. Revise enforcement policy so that more rigorous efforts are made to recover ill-gotten gains from the actual wrong-doers in prohibited transactions.

Please feel free to contact us for clarifications and for additional suggestions.

Sincerely,

Tim Jochim, Chair
Business Succession/ESOP Group