

A close-up photograph of a person's hands signing a document. The person is wearing a light blue button-down shirt. They are holding a black pen with a silver tip and are in the process of writing on a white sheet of paper. The background is blurred, showing what appears to be an office setting with other papers and possibly another person's hands.

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## The GreatBanc & DOL Settlement Agreement— How Have Things Changed?

By Dave Diehl

### Introduction

In the summer of 2014, there was a public announcement regarding the settlement of some ongoing litigation between the U.S. Department of Labor (the “DOL”) and GreatBanc Trust Company (“GBTC”) (the “Settlement Agreement”). We thought it would be helpful to the ESOP community to summarize our interpretation and ongoing responses to the Settlement Agreement as we plan for our continued involvement as a financial advisor to ESOP companies and ESOP Trustees going forward. This article addresses six important questions, however we recognize that there may be others. We would be delighted to engage in conversations on this topic with anyone interested in doing so.

### What is This?

The Settlement Agreement stems from an ESOP transaction involving Sierra Aluminum (the “Company”) as the sponsoring ESOP Company and

GBTC as the ESOP Trustee. In a lawsuit filed against GBTC, the DOL alleged that GBTC inappropriately relied upon financial projections provided by the Company. In the Settlement Agreement, the DOL called into question the processes that ESOP Trustees undertake to ensure that their financial advisors are adequately reviewing, testing and incorporating projections that are used to approve ESOP transactions. Their position is not new. In fact, plaintiff’s attorneys have recently presented other cases that have centered on the same DOL criticisms.

ESOP cases frequently get settled, but what makes this Settlement Agreement unique is it goes beyond a cash payment regarding the case at hand by (1) taking potential other contentious cases between the DOL and GBTC ‘off the table’ and (2) establishing very clear protocols to follow regarding the broader relationship between ESOP Trustees and their financial advisors. The protocols do not only deal with the specific issue of

analytically testing and utilizing projections, but they also cover the ESOP Trustee's process for assessing the qualifications and independence of financial advisors.

## How Has This Impacted the ESOP World?

Had the DOL and GBTC settled the Sierra Aluminum case privately, there would likely not be a need for us to write this paper. In most instances, litigation settlements impact one case and one set of litigating parties. Thus, they do not set a precedent in the traditional legal sense. As a condition to settling the case, however, both the DOL and GBTC agreed to openly discuss the Settlement Agreement in the public domain. Specifically, the DOL fired a warning shot suggesting that other ESOP Trustees should follow the protocols established in the Settlement Agreement. As a result, GBTC approached all of its major ESOP service providers to set forth their expectations. As one might imagine, knowledge of the Settlement Agreement spread very quickly throughout the ESOP community and many institutional ESOP Trustees have since made the business decision to follow suit, even though the 'safe harbor' afforded to GBTC does not extend to them.

At this point, even just a few short months after its finalization, the Settlement Agreement is being labeled as a collection of best practices in the ESOP world. Institutional ESOP Trustees and financial advisory firms working in the ESOP world will now be adhering to the Settlement Agreement, specifically as it relates to transactions.

## What Types of ESOP Events Does This Impact?

The Sierra Aluminum case involved an ESOP transaction, and the protocols in the Settlement Agreement have been interpreted to apply to all ESOP Trustees going forward. So, strictly speaking, the prevailing interpretation in the ESOP community is that the provisions of the Settlement Agreement are intended to apply to ESOP transactions, either at an initiating stage or at a follow-on stage. However, a number of the protocols involving the specific analytics of a

valuation can extend beyond transaction analyses to include ongoing ESOP valuations for ongoing plan administration. Accordingly, while some have viewed the provisions of the Settlement Agreement to apply solely to ESOP transactions, we believe that they can be viewed as best practices for annual ESOP valuations. For this reason, we believe the extension of the Settlement Agreement protocols to the full spectrum of ESOP-related valuations is inevitable.

## How Does This Impact Prairie's Work?

Let's start our answer to this question by categorizing the provisions of the Settlement Agreement into three basic groups: (1) valuation content and analysis, (2) the qualifications of the financial advisor to the ESOP Trustee and (3) the independence of that financial advisor.

1. **Valuation Content and Analysis** With regard to the first category, Prairie's analysis and reports don't reflect anything inherently at odds with the Settlement Agreement protocols. What will be required, however, is a more visible demonstration to the ESOP Trustee of the reflection of a number of specific things and how they have been factored into the analysis. Prairie is creating its own internal protocols to make sure that we adequately respond to each of the issues outlined in the Settlement Agreement. Our processes will be augmented to reflect these items in our information requests to the subject company, as part of our specific due diligence investigations with the subject company and in our internal review processes. In summary, the protocols will require an expansion and refinement of our processes, but they will not require us to perform any new types of analysis that are radical departures from our existing ways of completing valuations.
2. **Qualifications of the Financial Advisor to the ESOP Trustee** Over the last several years, we have seen an increase in the frequency of general Request for Qualifications ("RFQs") made by both institutional and internal ESOP Trustees. The specific RFQ questions have

varied but, collectively, include most of the information required in the Settlement Agreement. The Settlement Agreement requires that a presentation of such qualifications be provided to the ESOP Trustee prior to the engagement of the financial advisor. However, if there is an ongoing working relationship between the ESOP Trustee and a specific financial advisor, a RFQ only needs to be provided to the ESOP Trustee no less than once every 15 months. As a result of our experience responding to RFQs, this part of the Settlement Agreement adds time to our proposal process but does not require any new capabilities on our part.

- 3. Independence of the Financial Advisor** There is a clear consensus that the Settlement Agreement calls for a determination that the ESOP Trustee's selected financial advisor is independent of all parties to the transaction. More specifically, and while there has been and will continue to be significant discussion on this topic in ESOP circles, the guidelines in the Settlement Agreement implicitly state that a financial advisor to the ESOP Trustee cannot have previously performed work on behalf of an ESOP exploratory committee, where the seller(s) or representatives of the seller(s) are members of the exploratory committee. Historically, these exploratory committees were formed to assess the feasibility of an ESOP transaction in advance of the actual formation of the ESOP and the appointment of an independent ESOP Trustee.

Looking backwards, Prairie has performed valuations and transaction feasibilities on behalf of ESOP exploratory committees and have subsequently been hired by the independent ESOP Trustee to render transaction opinions. Our view is that some of the finest examples of employee ownership were formed with appropriately priced, vigorously negotiated transactions that began with an ESOP exploratory committee. That said, we accept the fact that this will change going forward. The institutional ESOP trustees we have spoken with have expressed their position on this, and they will likely view any such prior involvement as

an impairment of independence. Accordingly, Prairie will position itself as either a company/seller advisor or as an ESOP Trustee advisor, and we will make that determination immediately upon identifying an opportunity.

## What Has Prairie Done to Respond to the Trustee's Requests?

There are two action items we have initiated. First, with regard to the **valuation content and analysis** pursuant to the Settlement Agreement, we are constructing an appendix to our reports that will assist the ESOP Trustee in their review of these specific items. The appendix will detail the processes, assumptions, calculations and conclusions identified in the Settlement Agreement and tie them into other sections of our report for more detail. The appendix will be part of our report regarding both ESOP transactions and ongoing ESOP valuations for the reasons discussed previously; a best practice for ESOP transaction valuations should also be a best practice for ESOP update valuations used for plan administration purposes.

Regarding the **qualifications and independence** pursuant to the Settlement Agreement, Prairie is preparing a general qualifications and independence memorandum, which will be updated periodically. The memorandum will be provided to all ESOP Trustee clients and it will include comprehensive responses to all of the questions that surface in the various RFQs. It will be supplemented with project-specific information as requested, which may include things like industry experience, client references and other items, on an opportunity-by-opportunity basis.

We believe that the output of these action items will be of significant help to ESOP Trustees in their efforts to comply with the protocols reflected in the Settlement Agreement.

## How Will This Impact ESOP Companies?

Companies considering the formation of an ESOP, or existing ESOP companies considering a next-stage ESOP transaction, may find themselves compelled to (1) engage a Company-side advisor or

(2) conduct their own analysis. They will likely not have access to an ESOP financial advisor that can carry forward and serve as the financial advisor to the ESOP Trustee. For this reason, it is very likely that transaction timelines will be extended and all-in transaction costs for implementing an ESOP will increase.

## In Summary

While others reacting to the Settlement Agreement may choose to focus solely on its impacts to new ESOP transactions, we believe a better decision is to extend the Settlement Agreement guidelines to ESOP valuations prepared for ongoing administration. We believe that consistency in our work product is an absolute foundation of what we do. Therefore going forward, we will produce all ESOP related reports (transactions and updates) in a similar fashion. Prairie is going to exercise these best practices in everything we do. ESOP Trustees will ask for more detailed information and due diligence meetings may be more time consuming, which may result in an increase in costs to complete the ESOP valuation.

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