Best Practices in Interaction between the Board of Directors and Trustees

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In order to better understand the model of communication and responsibilities held between the Board of Directors and ESOP Trustees (or shareholders) of an ESOP Company, one should begin with an understanding of the corporate and ESOP plan structure.

The Board of Directors is the company's highest governing body. The Board is responsible for hiring, directing, and evaluating senior management – particularly the CEO. This leaves management to run the company's day-to-day operations, ensuring efficient operation of business functions. However, it is also the Board's duty to grow shareholder value while setting corporate rules, goals, and strategies. On top of these responsibilities, the Board also appoints and evaluates officers. The Board is also responsible for the hiring, firing and monitoring of ESOP Trustees and plan administrators.

Additional Board obligations include monitoring corporate performance, determining management compensation, and evaluating and approving significant transactions. This relates to the Board's accountabilities determined under applicable State corporate law, or the Corporate Fiduciary Standard.

Ultimately, the role of the Board of Directors is to direct the CEO and management. The Corporate Fiduciary Standard assigns the board both a duty of care and duty of loyalty. In Delaware and most other States, this incorporates the Business Judgment Rule. With the Business Judgment Rule, the court presumes that the directors' actions were informed, in good faith, and made with the honest belief that they were in the company's best interests. This places the burden of proof on the challenger – or, in this instance, the shareholder – to overcome presumption.

The legal allocation of duties and authority among a company's shareholders, Board, and officers is known as "Corporate Governance." In this instance of Corporate Governance, Trustees act on behalf of ESOP as a shareholder. When the company is a majority – or 100% ESOP – company, the ESOP is actually the controlling shareholder. In a minority ESOP company, the ESOP is often times the single largest shareholder.

Trustees are ERISA fiduciaries and must act solely in the interest of plan participants and beneficiaries, as well as for the exclusive purpose of providing benefits to them.

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Likewise, ERISA fiduciaries must act with the same care, skill, prudence, and diligence that a person acting in a similar capacity, familiar with such matters, would use in the conduct of an enterprise of similar character and with similar aims. The ERISA fiduciaries also must act in conformance with the plan and trust documents, so long as the documents are consistent with ERISA, of course.

Trustees can be employees, officers outside Board members or institutions. Trustees may have discretion and may also be directed by a committee, the plan administrator and sometimes the plan participants. Direction by participants is required only to the voting of allocated shares on certain major corporate matters, though some companies allow the participants to vote on the election of the Board of Directors.

Like the Board, the Trustee holds a number of roles as well. Additional roles of the Trustee include determining share value, monitoring performance of ESOP's shares, and hiring independent, qualified advisors, including the appraiser. Trustees safeguard the plan assets and must provide an annual accounting of the Trust. Trustees also comply with ERISA fiduciary duties and work to avoid prohibited transactions. Trustees ensure the plan is operated according to the plan document.

Just like the Board has an obligation to monitor the Trustee so must the Trustee monitor the Board of Directors. The Trustee through review of the Board minutes and financial statements will monitor the performance of the Company and the effectiveness of the Board. The Board has an obligation to keep the Trustee informed on major events that might happen including related party transactions, acquisitions and executive compensation issues. The Trustee should be informed and possibly involved should the Company receive an offer. Once the Board determines that an offer needs to be considered the Trustee should be notified. At least annually the Trustee should meet with the Board to discuss the 'Status of the ESOP'.

This status update between the Board and the Trustee should include an update from the Trustee on the following:

- If the Plan is leveraged, the Loan Payments and corresponding share releases should be reviewed.
- A review of the Allocation Reports including benefit levels and total plan assets.
- A discussion of the options for Participant Distributions, such as redemption versus recycling of the shares.
- Funding of the distributions should be discussed. i.e., lump-sum or installment payments.
- Lastly, the Board and the Trustee should have discussions on Repurchase Liability Planning.

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Keeping an open line of communications between the Board and the Trustee makes for good Corporate Governance. These two groups have the fiduciary duty to help make the Company be successful and good communications between them is the key to making this happen.

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