FIDUCIARY DUTIES OF ESOP TRUSTEES UNDER ERISA IN TENDER OFFERS: THE IMPACT OF HERMAN V. NATIONSBANK TRUST COMPANY AND A PROPOSAL FOR REFORM

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No man can serve two masters.
The Bible, Matthew 6:24.

When Louis Kelso introduced the first employee stock ownership plan ("ESOP") at Peninsula Newspapers, Inc. in 1954,1 twenty years before the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"),2 it was impossible to foresee the complex fiduciary duty issues that would later arise under ERISA for those who agreed to serve as ESOP trustees. After the enactment of ERISA in 1974 and the incredible growth of ESOPs,3 the opportunities for individuals and institutions to serve as ESOP trustees and the responsibilities imposed upon such trustees as plan fiduciaries increased exponentially. In addition to the goals of encouraging employee ownership in general, increasing worker productivity, and increasing the base of ownership of capital among U.S. businesses,4 ESOPs have served a number of other purposes as well. For example, given their tax-preferred status, ESOPs have been used successfully as vehicles for corporate finance.5 Likewise, particularly during the 1980s when corporate mergers and acquisitions accelerated to record numbers,6 ESOPs have served as management tools for defending against hostile takeover attempts.7 Soon after corporations began using ESOPs as a takeover defense mechanism, questions arose concerning the propriety of such use of a tax-qualified retirement plan. In particular, the application of such a plan by corporate management to defend against a hostile corporate takeover attempt raised serious questions regarding the fiduciary duties of ESOP trustees in the tender offer context.

The recent decision by the Eleventh Circuit Court of Appeals in

3. The National Center for Employee Ownership (NCEO) estimates that, as of 1998, there were 11,500 ESOPs and stock bonus plans covering 8.5 million employees, with plan assets valued at $400 billion. See A Statistical Profile of Employee Ownership (last modified Feb. 2000) <http://www.nceo.org/library/eo_stat.html>.
5. See infra note 35 and accompanying text.
7. See infra notes 37-38 and accompanying text.
Herman v. NationsBank Trust Co.\textsuperscript{8} represents an important development in the law concerning the fiduciary duties of an ESOP trustee under ERISA in connection with tender offers. While the decision clarifies an ESOP trustee's duties with regard to shares that are allocated to a plan participant's account (for which the trustee receives no voting instructions), it raises new questions concerning the duties that apply to unallocated shares. The uncertainty in this area of the law makes the position of an ESOP trustee quite perilous with regard to tender offers.

This Article will first review the general provisions of ERISA that concern the fiduciary duties of an ESOP trustee under the Act. The Article will then examine the definition of an ESOP and the general advantages of having an ESOP, followed by an analysis of the various interpretations of the fiduciary duty rules as applied in the tender offer context, with a focus on the\textit{NationsBank} case and its impact. Finally, the Article will propose a legislative change to address the remaining questions raised by the\textit{NationsBank} case which concern the fiduciary duties of ESOP trustees in this context.

I. FIDUCIARY DUTIES OF ESOP TRUSTEES UNDER ERISA

A. Fiduciary Duties Under ERISA

ERISA sets forth specific rules that govern the conduct of fiduciaries with regard to employee benefit plans. A person is a plan fiduciary under ERISA to the extent he (i) exercises any discretionary authority or discretionary control regarding the management of the plan or the management or disposition of its assets, (ii) renders investment advice for a fee or other compensation or has authority or responsibility to do so, or (iii) has any discretionary authority or discretionary responsibility in the administration of the plan.\textsuperscript{9} An ERISA fiduciary has four primary duties: (1) to act "for the exclusive purpose of... providing benefits to participants and their beneficiaries;" (2) to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would


\textsuperscript{9} See ERISA § 3(21)(A), 29 U.S.C. § 1102(21)(A) (1994). Thus, the trustee of a plan is a plan fiduciary based upon the trustee's responsibility to manage and control the assets of the plan.
ERISA imposes detailed requirements on trustees of employee benefit plans in connection with the performance of their duties. One or more trustees must generally hold all assets of an employee benefit plan in trust, and these trustees must generally have exclusive authority to manage and control the assets of the plan. However, where the plan expressly provides that the trustee is subject to the direction of a named fiduciary who is not a trustee, the trustee will be subject to the proper directions of such fiduciary where they are made in accordance with the terms of the plan and are not contrary to ERISA. In such instances, the trustee is commonly referred to as a "directed trustee."

An ERISA fiduciary is also subject to a number of other specific requirements. For example, ERISA provides that a fiduciary may not permit a plan to engage in a transaction if the fiduciary knows that such a transaction constitutes a direct or indirect sale or exchange of property between the plan and a party in interest. Likewise, a fiduciary who "has authority or discretion to control or manage the assets of a plan" is

11. ERISA provides several exceptions to the trust requirement relating primarily to insurance policies and plan assets held by insurance companies. See ERISA § 403(b), 29 U.S.C. § 1103(a) (1994).
13. A "named fiduciary" is a fiduciary who is named in the plan document or who, pursuant to a procedure specified in the plan, is identified as a fiduciary by a person who is an employer, an employee organization with respect to the plan, or an employer and employee organization acting jointly. See ERISA § 402(a)(2), 29 U.S.C. § 1102(a)(2) (1994).
15. The term "property," as used in this definition, would include securities of the plan sponsor. See generally ERISA § 407(a), 29 U.S.C. § 1107(a) (1994) (exempting from the prohibited transaction rules sales of qualifying employer securities under certain circumstances).
16. See ERISA § 406(a)(1)(A), 29 U.S.C. § 1106(a)(1)(A) (1994). The term "party in interest" includes any fiduciary, any person providing services to the plan, any employer whose employees are covered by the plan, certain 50% owners and certain employees, officers and directors of a party in interest, and certain family members of a party in interest. See ERISA § 3(14), 29 U.S.C. § 1002(14) (1994). Thus, the term "party in interest" will generally include the plan sponsor.

In addition to the sale or exchange of property transaction, other prohibited transactions include the lending of money or extension of credit between a plan and a party in interest; the furnishing of goods, services or facilities between the plan and a party in interest; the transfer to or use by a party in interest of any assets of the plan; and the acquisition on behalf of the plan of any employer security. See ERISA § 406(a)(1)(B)-(E), 29 U.S.C. § 1106(a)(1)(B)-(E) (1994).
prohibited from allowing the plan "to hold any employer security if the fiduciary knows or should know that holding such security" will violate ERISA section 407(a).\textsuperscript{17} ERISA section 407(a) provides that:

\begin{quote}
aplan may not acquire any qualifying employer security or qualifying employer real property, if immediately after such acquisition the aggregate fair market value of the employer securities and employer real property held by the plan exceeds [ten] percent of the fair market value of the assets of the plan.\textsuperscript{18}
\end{quote}

\subsubsection*{B. Definition and Advantages of an ESOP}

An ESOP is a special form of a defined contribution plan\textsuperscript{19} designed to invest primarily in qualifying employer securities.\textsuperscript{20} Because an ESOP is a tax-qualified defined contribution plan, it is subject to the qualification rules that apply to all such plans.\textsuperscript{21} To qualify as an ESOP, the plan must meet a number of additional requirements. First, because an ESOP, by definition, must be designed to invest primarily in employer securities, the prohibited transaction provisions of ERISA, sections 406 and 407,\textsuperscript{22} are inapplicable to the acquisition or sale of employer securities by an ESOP, as long as certain additional requirements are met.\textsuperscript{23} In order to qualify as an ESOP, a plan must provide for pass-through voting with regard to shares

\begin{footnotes}
\item[19] A defined contribution plan is a qualified retirement plan which provides for individual accounts for each participant and for benefits based solely on the amount contributed to the participant's account, as well as any income, expenses, gains and losses, and forfeitures of accounts of other participants which may be allocated to such participant's account. See I.R.C. § 414(i).
\item[20] See I.R.C. § 4975(e)(7). The term "qualifying employer security" includes common stock issued by the employer which is readily tradable on an established securities market, or, where there is no such stock (as in the case of a non-publicly traded corporation), common stock issued by the employer having voting power and dividend rights equal to or greater than the classes of common stock of the employer having the greatest voting power and dividend rights. See I.R.C. §§ 4975(e)(8), 409(l)(1)-(2). Non-callable preferred stock may be treated as qualifying employer securities if it is convertible into common stock meeting the above requirements at a conversion price that is reasonable. See I.R.C. § 409(l)(3).
\item[21] Such rules include the general plan qualification rules of I.R.C. § 401(a), the minimum participation and coverage requirements under I.R.C. § 410, the minimum vesting standards under I.R.C. § 411, and the limitations on contributions to the plan under I.R.C. § 415.
\item[22] See supra notes 16-18 and accompanying text.
\item[23] See ERISA § 408(e), 29 U.S.C. § 1108(e) (1994). Specifically, the acquisition or sale must be for adequate consideration, no commission may be charged with respect to the transaction, and the plan must be an individual account plan as defined in ERISA § 407(d)(3), 29 U.S.C. § 1107(d)(3) (1994), which defines an "eligible individual account plan" as any individual account plan, including an ESOP.
\end{footnotes}
allocated to participants' accounts.\textsuperscript{24} Pass-through voting in the case of a tender offer brings the named fiduciary and directed trustee rules discussed above into play.

An ESOP may acquire employer securities directly from the employer, from a current shareholder,\textsuperscript{25} or, in the case of a publicly held corporation, by purchasing the securities in the open market. While the ESOP is not the only type of qualified retirement plan that may acquire and hold employer securities,\textsuperscript{26} the ESOP is the only plan that may borrow

\textsuperscript{24} See I.R.C. § 409(e).

\textsuperscript{25} ESOPs are commonly used in non-public corporations to provide a shareholder owning a large block of the corporation's stock with a market for that stock upon retirement. I.R.C. § 1042 provides for a deferral of gain realized by a taxpayer on the sale of stock to an ESOP if: the shares sold constitute "qualified securities"; immediately after the sale, the ESOP owns at least 30% of either (i) each class of outstanding employer stock or (ii) the total value of all outstanding stock; the seller makes an election to apply I.R.C. § 1042 to the transaction (and meets certain procedural requirements under Treas. Reg. § 1.1042-1T, Q&A-3); and the seller purchases qualified replacement property within a fifteen month period beginning three months before the date of the sale to the ESOP. The securities sold must qualify as employer securities under I.R.C. § 409(l), must not have been received by the seller in a distribution from a qualified retirement plan or a stock option granted by the employer, and must have been held by the seller for a period of at least three years. See I.R.C. § 1042(b)-(c); Treas. Reg. § 1.1042-1T, Q&A-1(b). "Qualified replacement property" includes stock, certain rights to subscribe to stock, and certain bonds, notes, or other evidence of indebtedness issued by a domestic corporation with interest coupons or in registered form. See I.R.C. § 1042(c)(4). In all cases, the issuing company must be a domestic operating corporation (defined as one which has more than 50% of its assets used in the active conduct of a trade or business during the replacement period) and may not be the company issuing the section 1042 shares or any member of its controlled group. See id. The benefit provided by I.R.C. section 1042 is a deferral of the gain realized. The gain will be recognized by the taxpayer upon the disposition of the qualified replacement property, with certain exceptions, including transfers in a I.R.C. § 368 reorganization, upon the death of the taxpayer, pursuant to a gift, or pursuant to a contribution to a charitable remainder trust. See I.R.C. § 1042(e)(1), (3). The Internal Revenue Code also prohibits allocation of employer securities acquired in a section 1042 sale to the selling shareholder, members of his family, or 25% shareholders of the employer. See I.R.C. § 409(n).

\textsuperscript{26} Other qualified retirement plans may acquire and hold employer securities without violating ERISA's prohibited transaction rules. However, if the plan does not qualify as an "eligible individual account plan," it may not acquire and hold qualifying employer securities and qualifying employer real property in excess of 10% of the fair market value of the plan's assets. See ERISA § 407(a)(2), 29 U.S.C. § 1107(a)(2) (1994). An "eligible individual account plan" is "a profit sharing plan, stock bonus, thrift or savings plan," an ESOP, or "a money purchase pension plan which was in existence [on the date of enactment of ERISA] and which on such date invested primarily in qualifying employer securities." ERISA § 407(d)(3)(A), 29 U.S.C. § 1107(d)(3)(A) (1994). If a plan is an eligible individual account plan, the 10% limit does not apply, so long as the plan explicitly provides for the acquisition of qualifying employer securities and specifies the percentage of its assets that may be invested in such securities. See id. In addition, if the plan is a defined contribution plan but is not a profit sharing plan, and the stock is not readily tradeable on an established market, the pass-through voting requirements of I.R.C. § 409(e) will apply where more than 10% of plan assets are invested in employer securities. See I.R.C. § 401(a)(22).
An ESOP that borrows funds to acquire employer securities is known as a "leveraged ESOP." An ESOP that borrows funds to acquire employer securities is known as a "leveraged ESOP." In a leveraged ESOP, the ESOP may borrow the funds to acquire employer securities directly from the lender (normally with a guarantee from the employer), or the employer may borrow the funds from the lender followed by a loan from the employer to the ESOP. This latter structure is typically known as a "mirror loan" because the terms of the loan between the ESOP and the employer mirror the terms of the loan between the lender and the employer. In practical terms, the two structures are essentially the same. In both cases, the ESOP receives funds with which to purchase employer securities and the ESOP pledges the shares purchased as collateral for its loan. Employer securities acquired in a leveraged ESOP transaction are initially held in a suspense account. As the ESOP repays its loan, a portion of the securities held in the suspense account are released and allocated to the accounts of ESOP participants.

Once the securities are acquired, the employer generally makes contributions to the ESOP, which can then be used to repay the loan (either directly to the lender, or to repay the employer's loan and then the lender's loan). Generally, since contributions to the ESOP are contributions to a qualified retirement plan, the employer is allowed a deduction for such contributions.

27. See I.R.C. § 4975(d)(3), which provides for an exemption from the Code's prohibited transaction rules for a loan to a leveraged employee stock ownership plan if such loan is primarily for the benefit of participants and beneficiaries of the plan, and such loan is at a reasonable rate of interest and any collateral given to a disqualified person (including the employer sponsoring the plan) consists only of qualifying employer securities.

28. See generally I.R.C. § 4975(d)(3), which uses the term "leveraged employee stock ownership plan" to refer to such an ESOP.

29. Until very recently, I.R.C. § 133 provided an incentive for lenders to participate in leveraged ESOP transactions by excluding from gross income 50% of the interest received by a bank, insurance company, corporation actively engaged in the business of lending money or a regulated investment company from a loan, where the proceeds of the loan were used to acquire employer securities for an ESOP in such a transaction. I.R.C. § 133 has been repealed for loans made after August 20, 1996. See Pub. L. 104-188, Title I, § 1602.

30. Securities held in the suspense account are not yet allocated to the account of any individual participant and are therefore generally referred to as "unallocated shares."

31. The amount of securities released is determined in accordance with Treas. Reg. § 54.4975-7(b)(8)(i), which requires that, for each plan year during the duration of the ESOP loan, "the number of securities released must equal the number of encumbered securities held immediately before release for the current plan year multiplied by a fraction." That fraction's numerator is the amount of principal and interest paid for that plan year, while the denominator is the sum of the numerator plus the principal and interest to be paid for all future years. Thus, once the ESOP loan is completely repaid, all shares acquired with the proceeds of that loan will be fully allocated to the accounts of ESOP participants. See Treas. Reg. § 54.4975-7(b)(8)(iv), for an illustration of the operation of this release and allocation rule.

32. Once released from the suspense account, securities that are allocated to the accounts of ESOP participants are known as "allocated shares."
contributions, subject to the limits under I.R.C. § 404(a)(3). However, where the ESOP is a leveraged ESOP, the employer may be entitled to deduct principle payments as well as interest payments on the ESOP loan.

This ability to borrow funds to finance the plan's purchase of employer securities allows the ESOP to be used as a tool for corporate finance. For example, if the employer wishes to purchase a particular piece of equipment, it may finance the purchase through a loan from a bank or other lender, and receive a deduction for the interest paid on the loan and the annual depreciation on the equipment. However, the employer can receive substantial benefits by using an ESOP transaction. The employer may borrow the funds needed to purchase the equipment from the lender, then loan those funds to the ESOP. The ESOP will then use them to purchase employer securities equal in value to the amount of the loan, pledging the securities as collateral. The employer will use the proceeds from the sale of the securities (i.e., the funds received from the ESOP) to purchase its equipment. As the employer makes fully deductible annual contributions to the ESOP, the ESOP uses those funds to repay the loan to the employer, and the employer uses those funds to repay the loan from the lender. In addition to the interest and depreciation deductions in this transaction, the employer also receives a deduction for the principle payments on the loan, which provides a significant financing advantage.

Aside from utilizing an ESOP as a financing tool to provide a significant benefit to the employer, ESOPs have other beneficial uses as

33. I.R.C. § 404(a)(3) provides that an employer is entitled to a deduction for contributions to a qualified stock bonus or profit-sharing trust in an amount not in excess of the greater of 15% of the compensation paid or accrued on behalf of the participants in such stock bonus or profit-sharing plan, or the amount the employer is required to contribute to the plan under I.R.C. § 401(k)(11) (dealing with contributions required under a SIMPLE plan).

34. I.R.C. § 404(a)(9) allows a deduction for principal payments up to 25% of the compensation otherwise paid or accrued to employees in the taxable year, in addition to a deduction for contributions made to the plan used to pay the interest payments on the ESOP loan, all notwithstanding the limitations otherwise applicable under I.R.C. § 404(a)(3). In addition, under I.R.C. § 404(k), the employer is allowed a deduction for cash dividend payments on qualifying employer securities where; such dividends are either paid in cash to the participants in the plan or their beneficiaries, are paid to the plan and distributed in cash to the participants or their beneficiaries within 90 days after the close of the plan year in which paid, or are used to make payments on an ESOP loan, the proceeds of which were used to acquire the employer securities.


36. While providing an efficient and economical source of corporate financing generally serves a useful purpose, corporate managers have also found less socially acceptable uses for such financing. For example, Exxon Corporation was required to pay approximately $1 billion for the cleanup of the environmental damage from the Exxon Valdez oil spill in Alaska. However, rather than paying the administrative fine in cash, Exxon is reported to have set up an ESOP and used financing provided by the ESOP to pay
well. During the 1980s, as merger and acquisition activity accelerated to record proportions, the managements of publicly traded corporations began to realize the potential benefits of ESOPs as defense mechanisms against hostile takeover attempts. It is generally believed that because employees view hostile takeovers as significant threats to their job security, the personal interests at stake make employee investors friendlier to current management than outside public investors. Thus, in the face of a potential hostile takeover, management may consider implementing an ESOP in order to remove a block of shares from the public markets and place them in the hands of "friendly" employees.

As NationsBank illustrates, this takeover defense technique and the pass-through voting requirements applicable to ESOPs bring the named fiduciary and directed trustee rules discussed above into operation.

for a large portion of the cleanup. See Carl T. Hall, Critic Says Exxon Using ESOP to Pay for Spill, S.F. CHRON., Aug. 17, 1989, at C1. One commentator has suggested that by doing so, Exxon paid little of the fine from its own pocket. See Pietruska, supra note 35. At the very least, Exxon converted an otherwise nondeductible administrative fine into an ESOP loan for which both principle and interest will be deductible.

37. See Susan Chaplinsky & Greg Niehaus, The Role of ESOPs in Takeover Contests, 49 J. Fin. 1451 (1994); see also Susan P. Serota, Employee Benefit Plans in Corporate Acquisitions and Dispositions: Company Stock Held By Employee Plans, 20 REAL PROP. PROB. & TR. J. 1075 (1985). Of course, the use of an ESOP is not the only defensive measure that corporate management may employ in the face of a hostile takeover. Other defensive techniques corporations employ include repurchasing its own stock, seeking a "white knight" to purchase its shares in the open market, and issuing additional classes of stock, sometimes with additional voting rights. See Timothea M. Barnatan, Book Note, ESOPs as a Defensive Weapon When a Hostile Takeover Rears Its Ugly Head, 38 WAYNE L. REV. 1877, n.11 (1992) (citing SEC Act Release No. 15,230, Fed. Sec. L. Rep. (CCH) ¶ 81,748 n.3 (Oct. 13, 1978)).

For an interesting discussion of the social consequences of corporate management's various responses to hostile takeover attempts, see Patrick J. Ryan, Corporate Directors and the "Social Costs" of Takeovers - Reflections on the Tin Parachute, 64 TUL. L. REV. 3 (1989).

38. See Barnatan, supra note 37; Michael J. Nassau et al., ESOPs after Polaroid—Opportunities and Pitfalls, 15 EMPLOYEE REL. L. J. 347 (1989). Courts have differed in their approaches to the treatment of corporate management's attempts to use ESOPs as a defensive measure to a hostile takeover attempt. See NCR Corp. v. AT&T Co., 761 F. Supp. 475 (S.D. Ohio 1991) (holding that because the primary purpose of establishing the ESOP was to prevent a competitor's takeover offer and not to provide employees with benefits under the plan, the ESOP was invalid and unenforceable under Maryland law); cf. Grindstaff v. Green, 133 F.3d 416 (6th Cir. 1998) (holding that an ESOP administrative committee was able to vote ESOP shares in their best interest because ESOP shares are not a "plan asset" for purposes of ERISA).


40. See supra notes 9-18 and accompanying text.
II. THE HERMAN V. NATIONS BANK TRUST COMPANY CASE AND ITS IMPLICATIONS

A. Facts of the Case

The NationsBank case emerged from a hostile takeover attempt of Polaroid Corporation ("Polaroid") by Shamrock Acquisitions, III, Inc. ("Shamrock") in 1988. In September 1988, Shamrock made a tender offer for all of Polaroid's common stock. Partly in response to Shamrock's tender offer, Polaroid established an ESOP, the Polaroid Stock Equity Plan. Polaroid made a cash contribution to the ESOP in the amount of $15,000,000, and loaned the ESOP another $285,000,000, which the ESOP used to purchase over 9,700,000 newly issued shares of Polaroid common stock. The Polaroid shares purchased with Polaroid's cash contribution were then allocated to accounts for ESOP participants in proportion to their compensation, while the shares purchased with the loaned funds were held unallocated in a suspense account as collateral for the ESOP loan. As a defensive measure, Polaroid also made its own tender offer for its shares in January 1989. The offer was for $50 per share for a maximum of 16,000,000 of it's 71,500,000 outstanding shares, with a proviso that if more than 16,000,000 shares were tendered, Polaroid would buy tendered shares on a pro-rata basis.

On February 23, 1989, NationsBank, as trustee of the ESOP, mailed all ESOP participants an explanation of the competing tender offers and advised them that they should instruct NationsBank by March 23, 1989 either to (i) tender to Polaroid, (ii) tender to Shamrock, or (iii) not tender at

41. See NationsBank, 126 F.3d at 1357.
42. The Polaroid ESOP provided for pass-through voting, which allows participants to vote the shares allocated to their accounts like any other shareholder. The Polaroid ESOP also prohibited the trustee from tendering shares allocated to a participant's account unless the participant specifically instructed the trustee to tender and stated that the trustee should interpret a participants' silence as an instruction not to tender. With regard to unallocated shares held in a loan suspense account, the Polaroid ESOP provided for so-called "mirror-voting," meaning that the trustee is instructed to tender unallocated shares held by the plan in the same proportion as it tenders allocated shares. See id. Shamrock filed suit against Polaroid under Delaware state law, claiming that the establishment of the ESOP was an illegal anti-takeover device. Noting that the ESOP's voting provisions gave plan participants control over the ESOP shares, the Delaware Chancery Court held that the ESOP was not an illegal anti-takeover device and denied the injunction. See Shamrock Holdings, Inc. v. Polaroid Corp., 559 A.2d 257, 274 (Del. Ch. 1989).
43. See NationsBank, 126 F.3d at 1357.
44. See id. This type of leverage transaction is common with ESOPs. See supra notes 27-34 and accompanying text.
45. See NationsBank, 126 F.3d at 1358.
all. The NationsBank notice informed the participants that if they did not return an instruction form, their non-response would be treated as an instruction not to tender. The letter, however, did not advise participants of the mirror voting provisions concerning the unallocated shares.

That same date, the Secretary of Labor sent NationsBank an unsolicited letter outlining the Secretary's view of NationsBank's fiduciary responsibilities in light of the competing tender offers. NationsBank's Trust Policy Committee met to consider the tender options on behalf of the ESOP. Legal counsel advised the Committee that it had the responsibility to determine how the shares could be tendered prudently and to disregard the plan's provisions regarding the tendering of shares if it led to an imprudent result. After deliberation, the Committee concluded that because of the uncertainty in the post-tender market price of Polaroid stock, it was prudent to choose any of the available options, including the plan's provisions regarding tendering of the allocated and unallocated shares. On March 23, 1989, NationsBank tendered the ESOP shares in accordance with participants' votes and the terms of the Plan, including the mirror voting provision.

Eventually, Shamrock tendered each of its Polaroid shares to Polaroid. Of the shares tendered, Polaroid accepted 27.7747% of the shares. In accordance with its terms, the ESOP reinvested the proceeds it received for its Polaroid shares in Polaroid stock. As a result, the ESOP's stake in Polaroid was increased by 482,073 shares.

B. Procedural History of the Case

The Secretary of Labor filed suit against NationsBank in 1992, claiming that NationsBank violated ERISA §§ 404(a)(1)(A)-(B) by failing to tender all of the unallocated shares and the allocated non-voted shares to Polaroid. Under ERISA, a fiduciary is required to carry out its duties "(A) for the exclusive purpose of providing benefits to participants and their beneficiaries and defraying reasonable expenses of the plan, [and] (B)
with the care, skill, prudence, and diligence under the circumstances . . . that a prudent man acting in a like capacity and familiar with such matters would use." The Secretary also claimed that an indemnification provision in the ESOP, which provided that Polaroid "would indemnify NationsBank for any liability incurred in responding to tender offers so long as NationsBank followed the participant direction provisions in the plan, created a disincentive for NationsBank to exercise its independent judgment and, therefore, encouraged NationsBank to breach its fiduciary obligations under ERISA." The district court granted summary judgment to the Secretary with regard to this claim, and NationsBank did not seek certification of the district court's order with regard to the indemnification provision. Following discovery, the district court ruled that NationsBank could not rely on the participants' votes with respect to their allocated shares and the ESOP's mirror voting provision in the decision of how to tender the unallocated shares, and determined that NationsBank was required to exercise its independent judgment and follow plan provisions only if they led to a prudent result. The district court also found that NationsBank possessed exclusive responsibility for deciding whether to tender allocated non-voted shares, and that ERISA barred NationsBank from interpreting a participant's failure to respond as a direction not to tender. NationsBank requested that the district court certify for interlocutory appeal its order denying the parties' motions for summary judgment. The district court certified its order, citing the substantial ground for difference of opinion as to "the proper standard to be applied to the Trustee's decision on whether to follow the plan document and tender unallocated shares as directed by the participants." The Eleventh Circuit Court of Appeals granted permission for the interlocutory appeal.

C. Allocated Shares

1. Shares for Which Participant Direction Was Received (Allocated Voted Shares)

The Department of Labor did not raise any claims as to NationsBank's handling of the allocated shares for which a specific direction to tender or

53. NationsBank, 126 F.3d at 1359.
54. See id.
56. See id.
57. Id.
not tender was received. The parties apparently agreed that the ESOP provisions governing participant direction of the tendering of allocated shares controlled where the participant gave an explicit direction as to whether or not to tender the shares allocated to his account.\(^\text{58}\)

2. Shares for Which No Participant Direction Was Received (Allocated Non-Voted Shares)

As discussed above,\(^\text{59}\) the district court determined that NationsBank had the exclusive responsibility to determine whether or not to tender the shares allocated to participants' accounts for which no instructions were received. In addition, the district court found that, despite the provisions of the ESOP, NationsBank could not treat a non-response to the proxy materials as an instruction not to tender shares allocated to a participant's account.\(^\text{60}\)

On appeal, the Department of Labor reiterated its position from numerous letter rulings\(^\text{61}\) in support of the district court's findings. While the Eleventh Circuit agreed that the Department of Labor's position had been consistently set forth and was entitled to deference if reasonable, the court determined that the Department's position with regard to the allocated non-voted shares was unreasonable and therefore was not entitled to deference.\(^\text{62}\)

The court reasoned that participants may be named fiduciaries with regard to allocated shares because the participants have discretion to decide how those shares should be voted.\(^\text{63}\) The court held that participants do not lose control over their shares merely by failing to respond to a tender offer, at least where they are informed that such a non-response will be treated as a direction not to tender. In so holding, the court implicitly found that where the trustee informs participants about their options and how their non-responses will be treated, a non-response will constitute a "direction."\(^\text{64}\) The court also impliedly approved the language of the ESOP providing that the trustee may not tender shares allocated to a participant's account

\(^{58}\) See id. at 1362.

\(^{59}\) See infra notes 55-56.

\(^{60}\) See NationsBank, 126 F.3d at 1359.

\(^{61}\) See Polaroid Letter, supra note 47; Letter from Department of Labor to John Welch, 11 Pens. & Ben. Rep. (BNA) 633 (April 30, 1984) [hereinafter Welch Letter] (stating that the trustee of an ESOP retains a fiduciary responsibility for voting allocated non-voted shares); Letter to Ian D. Lanoff, 22 Pens. & Ben. Rep. (BNA) 2250 (Sept. 28, 1995) [hereinafter Lanoff Letter] (taking the position that ERISA allows ESOP participants to be named fiduciaries only with respect to those shares for which participants give explicit directions).

\(^{62}\) See NationsBank, 126 F.3d at 1364, 1371.

\(^{63}\) See id. at 1370.

\(^{64}\) See id.
without an express instruction from the participant, noting that such a provision is in accordance with the black letter law of trusts.\(^6\)

D. Unallocated Shares

In its analysis of the unallocated shares, the court's decision was much more ambiguous. The court began by addressing the question of whether or not the ESOP participants are "Named Fiduciaries" with regard to the unallocated shares.\(^{66}\) In order to be a named fiduciary, a person must first be a fiduciary. As the court noted, a person is not a fiduciary unless he either has discretion or exercises authority or control with respect to plan assets.\(^{67}\) NationsBank claimed that the ESOP participants were fiduciaries because they had the discretion to vote the unallocated shares based on the votes of their allocated shares through the mirror-voting provision.\(^{68}\) However, the court found that in order to exercise "discretion," a person must engage in "conscious decision-making or knowledgeable control over assets."\(^{69}\) Thus, the court held that the ESOP participants could not be named fiduciaries with regard to the unallocated shares where they were not informed that their action or inaction with regard to their allocated shares would control the disposition of the unallocated shares.\(^{70}\)

The court also discussed several policy arguments supporting different standards for allocated and unallocated shares. For example, the court noted that while control of allocated shares affects only the individual participant's account, if participants are given control over unallocated shares, their imprudent decisions may affect not only their interests but the interests of other participants as well.\(^{71}\) Furthermore, the court recognized that participants face little risk of liability where the potential loss affects only their account; however, if participants are found to be named fiduciaries with regard to the unallocated shares, they could face potential liability extending beyond the value of their own shares.\(^{72}\) The Department of Labor also argued both in the district court\(^73\) and on appeal that present participants have a conflict of interest with future participants and, because

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\(^{65}\) See id. (citing RESTATEMENT (SECOND) OF TRUSTS § 185 cmt. b (1959), which provides that "where by the terms of the trust it is provided that the trustee shall not do certain acts without the direction or consent of another, it is ordinarily his duty not to do such acts without such direction or consent.").

\(^{66}\) See id. at 1365.


\(^{68}\) See NationsBank, 126 F.3d at 1365.

\(^{69}\) Id. at 1366.

\(^{70}\) See id. at 1366-67.

\(^{71}\) See id. at 1367.

\(^{72}\) See id.

\(^{73}\) See id. at 1368 n.13.
the unallocated shares affect the interests of future participants, present ESOP participants may not make decisions regarding the voting of unallocated shares. However, the Eleventh Circuit found it unnecessary to address this argument, holding that the ESOP participants could not be named fiduciaries because they were not told about their control over the unallocated shares at the time they were given the tender offer choices. As a result, NationsBank retained the exclusive fiduciary authority to manage the tender of the unallocated shares. The court remanded the case for a determination of whether NationsBank acted imprudently in failing to tender the unallocated shares held by the ESOP, and whether NationsBank failed to act solely in the interests of plan participants in failing to tender the unallocated shares.

III. THE LAW AFTER NATIONALS BANK

A. Trustee Duties Regarding Allocated Shares

The NationsBank case clarifies an ESOP trustee's duties with regard to shares which are allocated to a plan participant's account for which no voting instructions are received by the trustee. It also provides direct authority for reliance on a plan provision which provides that a trustee may not tender allocated ESOP shares without the express direction of the ESOP participant. The case also grants a trustee authority to treat a properly informed participant's silence or failure to return a tender solicitation as an instruction not to tender. As in the NationsBank case itself, though, whether or not the tender solicitation materials provide sufficient information and disclosure remains a factual issue subject to dispute. ESOP trustees would therefore be well advised to make the effect of a participant's failure to return the tender offer solicitation as clear as possible in the tender solicitation materials.

74. See id. at 1368.
75. See id.
76. See id. at 1369. The court also remanded the case for a determination of whether the instructions given to plan participants with regard to the allocated non-voted shares were proper.
77. See id. at 1370. The court quoted with approval the Restatement (Second) of Trusts § 185 cmt. b. (1959), which provides that "[w]here by the terms of the trust it is provided that the trustee shall not do certain acts without the direction or consent of another, it is ordinarily his duty not to do such acts without such direction or consent."
78. See id. ("If the trustee informs participants of their choices, and participants are reminded at the time of decision how the trustee will treat non-responses to the trustee's request, then the non-responses suffice as guidance, or directions, for the trustee.").
B. Trustee Duties Regarding Unallocated Shares

At the same time, the *NationsBank* case raises new questions concerning the fiduciary duties that apply with regard to unallocated shares. Specifically, if participants were informed of the effect of a mirror-voting provision similar to the one contained in the Polaroid ESOP, could they be treated as named fiduciaries with regard to the unallocated shares as well? Further, what policy considerations support either construction, and should the law in this area be clarified to reflect these policy considerations?

The position of the Department of Labor with regard to the voting of unallocated shares appears clear: ESOP participants simply cannot be named fiduciaries with regard to unallocated ESOP shares.\(^7\) However, while the Eleventh Circuit recognized that a mirror voting provision is not per se violative of ERISA,\(^8\) the court did not rule on this issue.

The Department of Labor's position and the uncertainty created by the *NationsBank* case put a directed ESOP trustee in an untenable position where the ESOP contains mirror voting language. If the ESOP trustee follows the terms of the ESOP and applies the mirror voting provision, allowing participants' votes as to allocated shares to control the vote on the tender of unallocated shares, the trustee risks a claim by the Department of Labor that it has violated the prudence requirement of ERISA § 404(a)(1)(B). On the other hand, if the ESOP trustee refuses to follow the terms of the ESOP, ignores the wishes of the ESOP's participants (as expressed in their votes with regard to the allocated shares) and votes the unallocated shares in accordance with the trustee's own view of what is a prudent course of action, the trustee risks a suit by ESOP participants for failing to follow the terms of the plan in violation of ERISA § 404(a)(1)(D) and I.R.C. § 401(a)(4), particularly if post-tender events lead to a financial loss on the part of the ESOP trust due to the trustee's decision. Thus, the trustee finds itself in the unenviable position of facing a possible lawsuit regardless of which position it takes and which position is, in fact, correct.

One possible solution to this dilemma is to amend the ESOP plan document by removing the mirror voting provisions.\(^8\) However, because of employee relations concerns, plan sponsors may not wish to take away the benefit of giving ESOP participants control over the shares held by the

\(^7\) See id. at 1369-70; see also Letter Regarding Profit-Sharing Retirement Income Plan for the Employees of Carter-Hawley Hale Stores, Inc., 11 Pen. & Ben. Rep. (BNA) 633 (April 30, 1984); Lanoff Letter, supra note 61; Polaroid Letter, supra note 47.

\(^8\) See *NationsBank*, 126 F.3d at 1368.

\(^8\) Such an amendment would not violate I.R.C. § 411(d)(6), which prohibits any plan amendment that eliminates any protected optional form of benefit. See Treas. Reg. § 1.411(d)-4, Q&A 1(d)(6), which provides that the right to direct plan investments is not a protected benefit under I.R.C § 411(d)(6).
Further, ESOPs, like most qualified plans, generally contain provisions that limit a plan sponsor's ability to amend the ESOP without the consent of the trustee where the effect of the amendment would be to increase the duties of the trustee. As a practical matter, the trustee will be unwilling to assume the additional liabilities inherent in making a fiduciary decision as to how the unallocated shares should be voted and may prefer to simply resign as trustee rather than accept the proposed amendment. Such concerns are, of course, part of the reason mirror voting provisions are included in plan documents in the first place. Given the choice between the uncertainty in the law as it now exists and the additional potential liability they face from removing the mirror-voting provisions, it seems likely that, at best, trustees will significantly increase their fees for serving as trustee, resulting in higher costs to the plan sponsor and the ESOP participants; at worst, it may become difficult to find qualified institutions willing to serve as ESOP trustees.

As NationsBank correctly noted, there is no provision of ERISA that specifically requires disparate treatment for allocated and unallocated shares.\textsuperscript{83} Further, there is no provision expressly prohibiting ESOP participants from being named fiduciaries with respect to allocated and unallocated shares held by the ESOP.\textsuperscript{84} The law on these points is ambiguous. Given this ambiguity, and especially in light of the dilemma in which directed ESOP trustees currently find themselves, it would be appropriate for Congress to consider this issue and resolve this uncertainty by legislative action. In order to do so, it will be necessary to consider the policy concerns that the parties, the district court, and the Eleventh Circuit raised in the NationsBank case with regard to ESOP participants serving as named fiduciaries of the unallocated shares. It will also be necessary to balance these concerns against the effect the resolution of this issue would have with regard to qualified institutions serving as ESOP trustees and the cost effect of such resolution on plan participants. The remainder of this article will consider these policy issues and attempt to establish a framework for proposed legislative reform.

In the NationsBank case, while the Eleventh Circuit hinted that an ESOP participant could be a named fiduciary with regard to unallocated ESOP shares if properly advised of his status, the court also noted a number of policy considerations that mitigate against such a finding.\textsuperscript{85}

\textsuperscript{82} This would be particularly true in the context of a hostile takeover attempt, where a target corporation's employees are generally viewed as being opposed to the attempted takeover.

\textsuperscript{83} See NationsBank, 126 F.3d at 1366.

\textsuperscript{84} In fact, I.R.C. § 409(e), which requires that plan participants be given pass through voting, would seem to imply that participants can be given the equivalent of named fiduciary status with regard to allocated shares.

\textsuperscript{85} See NationsBank, 126 F.3d at 1367.
Specifically, the Court was concerned with the effect that allowing current ESOP participants to direct the vote as to the unallocated shares would have on other plan participants and the potential liability issues inherent in being a named fiduciary.

C. Policy Considerations

1. The Effect on Other Participants

The Eleventh Circuit first addressed the effect that allowing current ESOP participants to direct the vote as to unallocated shares would have on other plan participants. As the court noted, there is a difference between the effect of participant elections with regard to allocated and unallocated shares: "[w]ith allocated shares the person injured by a participant's imprudent decision is that participant. By contrast, if participants are given the ultimate control over unallocated shares, their imprudent decisions affect the interests of not only themselves but also the interests of their co-participants."

NationsBank argued on appeal that because the trustee was able to reinvest all the tender proceeds in Polaroid stock and to reacquire a greater number of shares than the number of shares tendered, and because these additional shares were allocated solely to the accounts of present participants, the decision of whether or not to tender the ESOP shares had no effect on the number of shares allocable to future participants. According to NationsBank's argument, the unallocated suspense account retained exactly the same number of shares as it had prior to the tender.

From a policy standpoint, however, NationsBank's argument is flawed in that it will only apply in situations like the NationsBank case, where post-tender events worked in the trustee's favor. The only reason that the suspense account did not sustain a loss is because the price of Polaroid stock decreased significantly between the date the shares were tendered and the date the trustee of the ESOP reinvested the proceeds of the tender in Polaroid stock. Had the price of Polaroid stock increased during this period, the trustee would not have been able to purchase as many shares with the tender proceeds and the number of shares of stock held by the ESOP suspense account would have decreased. Thus, contrary to

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86. Id.
88. For example, if Polaroid's stock price had increased to $60 per share during this period, the $72,762,200 the ESOP received would have been reinvested in 1,212,703 Polaroid shares, a decrease of 242,540.7 shares.
NationsBank's assertion, the decision to tender or not tender did have an effect on the number of shares allocable to future participants; in this case, due to the decrease in the price of Polaroid stock, that effect was positive. The fact that this case yielded a positive result does not support the argument that participants' actions with regard to the unallocated shares do not affect the interests of other participants, present or future.

The district court found that participants couldn't be named fiduciaries with regard to the unallocated shares because of an inherent conflict of interest, which would not adequately safeguard the interests of so-called "future participants." On appeal, NationsBank argued that the district court erred in this finding because, under ERISA § 404(a)(1)(A), fiduciaries must exercise their duties "for the exclusive purpose of providing benefits to participants and their beneficiaries." NationsBank claimed that ERISA's definition of the term "Participant" does not confer protection upon employees who may be hired in the future. However, the definition of "Participant" under ERISA is "an employee or former employee... who is or may become eligible to receive a benefit..." NationsBank's narrow reading of the definition is inappropriate. Under the terms of the plan document, certain employees will, in fact, become participants in the future. These employees will have a right to a portion of the shares held in the ESOP's unallocated suspense account at that time. While it is not possible to determine which employees will receive an allocation or what allocation they will receive, it is clear that at least some of these shares will be allocated to the accounts of future employees. Further, it is more likely than not that at least some of the employees will be new hires that are not current employees. To argue that these future participants are not entitled to a portion of the shares held unallocated in a suspense account is, in the most favorable light, disingenuous.

Regardless, the Eleventh Circuit found it unnecessary to reach the "future participants" issue. As the court correctly noted:

[i]f many participants acted imprudently, or merely neglected to respond, under a plan containing a mirror voting provision, the unallocated share pool could suffer significant losses. One participant might lose part of the value of his stake in the unallocated share pool due to another participant's imprudent decision or non-decision.

Even if NationsBank is correct that the interests of future participants should not be considered, the interests of current participants in the

90. Brief of Defendant-Appellants, supra note 87, at 24 (citing ERISA § 404(a)(1)(A)).
92. NationsBank, 126 F.3d at 1367.
unallocated share pool will be affected by imprudent or non-decisions by ESOP participants with regard to the tender offer. This consideration supports the conclusion that ESOP participants should not be held as named fiduciaries with regard to unallocated ESOP shares.

2. Potential Liability Issues

The second policy consideration addressed by the Eleventh Circuit was the potential liability to which a participant could be subject in the event of an imprudent decision. As the court noted, there is a distinction between a participant controlling the vote with regard to shares allocated to his account, for which only he could be subjected to losses, and with regard to unallocated shares, in which other participants have an interest.

A participant's risk for acting imprudently with regard to shares allocated to his own account is limited to the potential investment loss his account may suffer; a participant would not and could not sue himself for breach of fiduciary duty. In contrast, if participants are treated as named fiduciaries with regard to unallocated shares, they could face possible liability, beyond the loss to their own accounts, for imprudent decisions concerning the vote on unallocated shares. As the court points out, "NationsBank has pointed to nothing in ERISA that would bar co-participants, the ESOP itself or the Secretary [of Labor] from suing participants when they make imprudent decisions with regard to unallocated shares." The court found this potential liability unacceptable, especially where the participants were inadequately informed of the responsibilities and potential liability involved.

The question remains, however, whether or not a participant could nonetheless be a named fiduciary with regard to unallocated shares, subject to the potential liability discussed above, even with proper notice. The Eleventh Circuit raised (but did not address) this question, speculating that a plan which imposed named fiduciary status automatically might be required to give participants a chance to opt-out of such responsibilities and liabilities. Whether or not participants could legally be given an opportunity to opt-out of service as named fiduciaries is unclear. However, even if the participant was given the information concerning the potential liabilities he faced for his decision, policy considerations weigh against allowing a participant to serve as a named fiduciary with regard to unallocated shares. First, imposing named fiduciary status on plan participants, subject to the right to opt out of such status, would place a substantial additional administrative burden on the plan and the trustee.

93. Id.
94. See id.
Further, some of the same concerns underlying the decision which involved the tender of unallocated shares in the *NationsBank* case would arise. If a participant fails to opt-out of named fiduciary status, how can a plan administrator be certain the participant received the information concerning his potential liability and made a willing and informed choice to subject himself to such liability? This concern is particularly acute when considered in conjunction with the mirror voting provisions. A participant could be held liable for failing to affirmatively vote securities after failing to affirmatively accept or reject fiduciary status. While it is possible that the participant made a conscious, informed decision regarding his fiduciary status and the decision to tender or not tender unallocated shares, it is also possible that the participant simply did not receive the tender package. In essence, a participant could be held liable for losses from the tender offer simply because the information mailed to him was lost in the mail. Such liability seems particularly unfair.

Even assuming that, despite the above concerns, a participant could be a named fiduciary with regard to unallocated shares, a great deal of uncertainty would remain. The sufficiency of the information provided to participants concerning their fiduciary duties, potential liabilities regarding the voting of unallocated shares, and their ability to opt-out of fiduciary status, will most certainly be called into question. Participants who are subjected to claims for breach of fiduciary duty by co-participants, the ESOP or the Secretary of Labor will undoubtedly argue that even though they received the information, they did not comprehend the potential liabilities to which they were subjecting themselves in voting (or failing to vote) the unallocated ESOP shares. The prospect of imposing liability on a highly compensated executive for his investment decisions that affect other participants may be desirable from a policy standpoint. However, the prospect of imposing similar liability on a non-highly compensated factory worker who has limited formal education and claims not to have understood the responsibilities he was undertaking is a significantly more troublesome issue. Imposing liability on such an individual, even if appropriate under current legal standards, is certainly an undesirable result.

**D. Proposed Legislative Correction**

The uncertainty in the law and potential participant liability concerning unallocated shares as it now exists is unacceptable. Congressional action to remedy the concerns addressed above is appropriate, and, given the policy considerations discussed above, two alternatives should be considered.

First, Congress could adopt the Department of Labor's position regarding unallocated shares by amending ERISA and/or the Code to
specifically prohibit plan participants from directly or indirectly voting unallocated shares. ESOP trustees would then be required to exercise fiduciary responsibility in determining how such shares should be voted. This alternative removes the uncertainty in the current law and addresses the first policy concern discussed above - the effect that allowing current ESOP participants to direct the vote as to the unallocated shares would have on other plan participants. However, as discussed above, requiring ESOP trustees to accept the certainty of such fiduciary responsibilities would likely have the effect of increasing costs for ESOP trustees' services, and may tend to decrease the number of individuals and institutions willing to serve as ESOP trustees.95

Even when qualified individuals and institutions can be found to serve as ESOP trustees, the process of applying the fiduciary duty rules to the decision whether or not to tender unallocated shares held by the ESOP is problematic. For example, it is unclear whether the trustee should make its decision based upon what is best for the group of unallocated shares as a whole, or whether the effects of the tender offer on one or more groups of participants should be taken into account.96 For example, consider an employer with multiple groups of employees that may have significantly different interests. Would the interests of a company's sales force, for example, necessarily coincide with the interests of the company's factory workers? Would an airline's baggage handlers have the same concerns in a hostile takeover situation as a group of pilots? The discrepancies between the interests of various employee groups97 provides significant

95. One commentator has suggested that a possible alternative for making certain that tender offer decisions are made in the best interests of plan participants and beneficiaries is to amend ERISA to require the appointment of independent fiduciaries for pension plans. See Susan J. Stabile, Pension Plan Investments In Employer Securities: More Is Not Always Better, 15 YALE J. ON REG. 61, 106 (1998). This argument is a subset of the first alternative discussed in the text above, in that it requires the ESOP trustee to accept fiduciary responsibility for making the tender offer decision. Professor Stabile's suggestion would address the first concern of the NationsBank court (the effect of a decision on the accounts of other plan participants); however, this alternative suffers from the same problems as the larger alternative—a tendency to increase costs for ESOP trustees' services and to decrease the number of qualified individuals and/or institutions willing to serve as ESOP trustees.

96. The effect of a possible hostile takeover on the trustee or another plan fiduciary making a tender decision is another potential source of conflict for the plan fiduciary that might lead to a breach of fiduciary duty claim. See Laurence B. Wohl, Fiduciary Duties Under ERISA: A Tale of Multiple Loyalties, 20 U. DAYTON L. REV. 43 (1994).

97. Outside the hostile takeover context, these same issues arise within the employer's workforce generally, with younger employees preferring an investment strategy that emphasizes capital growth (and therefore more risk) and older workers preferring a strategy that emphasizes safety and preservation of capital (and therefore less risk). See Stabile, supra note 95, nn.209-14 and accompanying text; Wohl, supra note 96, n.49 and accompanying text (citing Foltz v. U.S. News & World Rep., Inc., 865 F.2d 364 (D.C. Cir.), cert. denied, 490 U.S. 1108 (1989)). In Foltz, the court rejected the plaintiffs' argument that
complications for the trustee making these decisions, especially where a
decision regarding the unallocated shares will impact various employee
groups differently.

Given these concerns, it appears that a better alternative is for
Congress to amend ERISA to specifically allow plan participants to vote
directly or indirectly the unallocated shares while at the same time
providing them with legislative protection against liability. The
amendment should also require the Department of Labor to publish
regulations which set standards for the information that must be provided to
plan participants before they can be given voting responsibilities. This
information should be similar to that required under ERISA section
404(c).

This legislative action would clarify the uncertainties of the current
law and address the second policy consideration discussed above— the
potential liability to which participants might be subjected under current
law in voting unallocated ESOP shares. This alternative is not likely to
increase significantly the costs of ESOP trustees or to produce a chilling
effect on the willingness to serve. This alternative also addresses the

ERISA's exclusive benefit requirement creates a fiduciary duty of maximizing the current
value of benefits rather than the long-term growth of plan assets and indicated that the
proper weighing of these two goals has traditionally been measured against an "arbitrary and
capricious" standard. Professor Wohl suggests that the court's language in effect imposes a
"business judgment rule" type of analysis.

98. This liability protection could be structured in a manner similar to ERISA §
404(c)(1), 29 U.S.C. § 1104(c)(1) (1997), which provides that, where a plan provides for
individual accounts and permits a participant or beneficiary to exercise control over the
assets in his account, and the participant or beneficiary does in fact exercise control over the
assets in his account, then such participant is not deemed to be a fiduciary by reason of such
exercise, and no other fiduciary shall be liable for any loss which results from such control.
In effect, this provision relieves plan fiduciaries from liability for participant-directed
investments. In order to qualify for this protection, the plan must provide the participant
with the opportunity to choose from a broad range of investment alternatives, give
investment instruction with a frequency appropriate in light of the market volatility of the
investment alternatives, and obtain sufficient information to make informed decisions with
respect to the available investment alternatives.

99. The Department of Labor regulations issued under ERISA § 404(c) provide detailed
rules for the types of information that must be provided in order for a participant's decision
to be considered "informed." Included in the regulations are, inter alia, a description of
each investment alternative and information relating to its risk and return characteristics,
identification of any designated investment managers, and a description of transaction fees
and other similar expenses. In addition, the regulations stipulate that certain other
information must be provided to the participant or beneficiary upon request; namely, a
description of the annual operating expenses of each investment alternative, copies of
prospectuses and similar financial information if provided to the plan, information
concerning the value of shares or units in the various investment alternatives, and
information on past and current performance on a reasonable and consistent basis, as well as
conflict of interest between various employee groups discussed above. As each employee would be allowed to vote a proportionate amount of the unallocated shares, the potential for the trustee's decision to harm any individual group is eliminated.

It is true that this second alternative does not directly address the effect that the ability of current ESOP participants to direct the vote of the unallocated shares will have on the accounts of other plan participants. From a policy standpoint, an analogy can be drawn between allowing participants to direct the vote as to a proportionate amount of the unallocated shares, and allowing participants to direct investments concerning the non-vested portion of matching and profit sharing accounts. In both instances, participants' actions can have a significant effect on the accounts of other plan participants. Participants can and do routinely direct the investment of the non-vested portions of their accounts, even though there is no assurance that these non-vested portions will become a permanent part of a participant's account and provide a benefit to that participant.

The analogy to participant direction of investment decisions regarding the non-vested portion of matching and profit sharing accounts is imperfect. The goals of the participant in the two circumstances will not always be exactly identical. For example, in making investment decisions, we would generally expect a participant to make decisions with a view toward maximizing the investment return for her account. In deciding on a response to a hostile tender offer, however, outside influences will almost certainly become a factor. In the case of a successful tender offer, the participant's future employment status would have an effect on the participant's decision. Nonetheless, the potential effect in both circumstances is the same. In both instances, a participant is given a choice that has the potential to affect the balance in another participant's account, especially if the matching and/or profit sharing funds are invested entirely or partially in employer stock. It seems logical that where the ultimate effect is the same, the law should allow participants the same rights in both instances.

100. See supra notes 96-97 and accompanying text.

101. Outside influences may occasionally have an effect on investments. For example, an employee may invest in "socially conscious" mutual funds that base investment decisions not only on potential investment return, but also on outside factors such as a company's environmental policies, social policies, or other considerations.

102. The potential for a conflict of interest between different employee groups becomes significant here as well. Upper and middle level management employees, for example, are more likely to be adversely affected by a successful hostile takeover attempt than lower level "rank and file" workers, at least on an immediate, short-term basis.
IV. CONCLUSION

The *NationsBank* case represents an important development in the law concerning the fiduciary duties of an ESOP trustee under ERISA in connection with tender offers for employer securities. The case clarifies an ESOP trustee's duties with regard to allocated non-voted shares. However, the case raises new and difficult questions concerning the duties that apply with regard to unallocated shares, resulting in potential liabilities for ESOP trustees when a tender offer occurs. This uncertainty and potential liability is likely to make competent ESOP trust services more expensive or impossible to obtain. Given the uncertainty in the law as it currently exists, Congress should consider enacting legislation to clarify the law in this area. At least two policy considerations, (1) the effect that allowing current ESOP participants to direct the vote as to the unallocated shares would have on other plan participants and (2) the potential liability issues such participants are likely to face, suggest that legislation should be enacted to either prohibit plan participants from directly or indirectly voting unallocated shares or allowing plan participants to vote such shares under an ERISA provision similar to ERISA section 404(c) that provides participants protection against liability. Taking both of these competing policy considerations into account, the better alternative appears to be the latter.