



**SOUTHERN FEDERAL
TAX INSTITUTE**

**ESOP AS AN OPTION FOR OWNERSHIP
TRANSITION: WHAT YOU AND YOUR CLIENTS
NEED TO KNOW**

By

Castles R. Hollis
Bryan Cave Leighton Paisner LLP
Atlanta, GA

Blake Head
BDO Capital Advisors, LLC
Atlanta, GA

Andrew J. Kulesza
Independent Board Member-Former CEO
ESOP Owned S-Corp
Cincinnati, OH

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Castles (Cass) Hollis

Partner

Bryan Cave Leighton Paisner LLP

One Atlantic Center, 14th Floor

1201 W. Peachtree St., N.W.

Atlanta, GA 30309-3471

(404) 572-6676

cass.hollis@bclplaw.com

Cass leads BCLP's Employee Benefits and Executive Compensation group, focusing her practice on employee benefits and executive compensation matters, with a particular expertise in employee stock ownership plans (ESOPs). Her practice is anchored in the design, implementation, and ongoing compliance of both qualified and non-qualified retirement plans. Cass advises on a broad spectrum of benefit structures, including welfare benefit plans, deferred compensation arrangements, bonus programs, and equity incentive plans, making her a trusted and versatile advisor in the employee benefits space.

A significant focus of Cass's work involves ESOP-related transactions. She has represented companies, lenders, and trustees in structuring these transactions to ensure that the financial and strategic goals of the organization as well as the complex regulatory requirements are satisfied. Her nuanced understanding of ESOPs allows her to offer clear, actionable advice at every stage from transaction structuring to long-term compliance with administration for ESOP-owned companies.

In addition to her retirement plan expertise, Cass provides strategic counsel on executive compensation matters, including the negotiation and drafting of executive employment agreements and equity-based incentive plans. She works closely with clients to ensure that these agreements align with their organizational goals while safeguarding their interests. Her depth of knowledge in this area is further reflected in her role as a co-author of *Executive Compensation – Best Practices (393-1st T.M.)*, a Bloomberg-published portfolio offering key insights on effective compensation design and regulatory compliance.

Cass also works with clients navigating benefits issues in corporate transactions, assisting in the correction of defects in tax-qualified retirement plans, and the establishment and maintenance of Association Health Plans. Cass's holistic and detail-oriented approach empowers clients to manage complex legal and regulatory requirements with confidence.

In addition to her legal practice, Cass is involved in The ESOP Association. She currently serves on The ESOP Association's Legal and Regulatory Committee and previously served on the Public Policy Council.



Blake Head

Managing Director, ESOP Advisory Group Head
BDO Capital Advisors, LLC
Atlanta, GA
bhead@bdocap.com
(404) 979-7122

Blake is a Managing Director at BDO Capital Advisors, LLC, and the leader of BDO Capital's ESOP Advisory Services division. He has more than 17 years of corporate financial advisory experience. Blake focuses on providing a variety of services to clients, including valuation analyses, review of strategic alternatives for owners considering an exit, raising capital from both non-traditional and traditional lenders, and advisory services related to the sale, merger and divestiture of privately-held companies. His experience lies in helping clients assess the feasibility of ESOPs and, thereafter, structuring, negotiating and executing successful sales to ESOPs.

Prior to joining BDO Capital Advisors, Blake was a Partner at BDO USA and the National Group Leader for BDO USA's People and Organization Strategy. His group was comprised of ESOP Advisory Services, Executive Compensation Consulting and Workforce in Transactions practices. Blake's experience in compensation matters included benchmarking and surveying projects, design and implementation of performance management review systems, and the design and implementation of performance incentive plans for executive, non-executive, and sales employees. He has worked with both for-profit and tax-exempt entities. Blake has consulted with a variety of manufacturing, construction, retail, technology, and oil and gas industry firms in the area of compensation and broad-based rewards. In addition, he has extensive experience in consulting on employee benefit plans.



Andrew J. Kulesza

Independent Board Member ESOP Owned S-Corp

Former CEO ESOP Owned S-Corp

Cincinnati, OH

(513) 906-0154

ajkulesza@outlook.com

Andrew currently serves as an independent board member for a 100% ESOP-owned S-Corp based in Kentucky. With over 20 years of experience in the ESOP space, he most recently held the position of Vice President in J.P. Morgan's ESOP Advisory Group, maintaining a FINRA 63/79 registration. Andrew collaborated with bankers, clients, and prospects across the lower Midwest to the Gulf Coast, providing guidance to management teams throughout all stages of ESOP ownership and executing various ESOP transactions. Previously, he worked as a middle-market commercial banker at Fifth Third Bank.

Before returning to banking, Andrew held successive roles as CFO, followed by President/CEO and internal trustee of a multi-state, 100% ESOP-owned S-Corp. Addressing mature ESOP challenges, he successfully oversaw the sale of non-union subsidiaries, paying out over 90% of the approximately 300 participants at multi-year share price highs. Subsequently, he managed the wind-down of legacy entities and executed on the termination of the ESOP plan in his capacity as internal trustee.

In addition to his extensive banking and corporate experience, Andrew has held various leadership positions within The ESOP Association, including on the Board of Directors, Board of Governors, and Fiduciary Committee. As an advocate for ESOP ownership, he assisted in securing bipartisan co-sponsorship for H.R. 3586, the "S-Corporation ESOP Promotion and Expansion Act of 2009".

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I. ESOP Overview

A. Defined

An “employee stock ownership plan” or “ESOP” is a type of qualified defined contribution retirement plan as defined in Section 4975(e)(7) of the Internal Revenue Code (“Code”). An employee stock ownership plan is designed to primarily invest in qualified employer securities of the corporation that establishes the plan, with these shares held in a trust that is exempt from income tax under Section 501(a). An ESOP is not a stock option program. Employees of the plan sponsor are participants in the plan and have a beneficial interest in the assets of the ESOP trust.

B. Background

Louis Kelso is credited for the concept of ESOPs with an idea for a client. Kelso used the assets of a profit-sharing plan for a 30% down payment with a bank financing the remaining 70%. Later he published *The Capitalist Manifesto* in 1958 which he followed up with *The New Capitalists* in 1960. The goal was to “free” workers and provide a path to company ownership.

Russell Long, son of populist Louisiana Governor, Huey Long, was a U.S. Senator and Chair of the Senate Finance Committee. Senator Long was the key legislator to embrace and promote the idea of “Kelso Plans” or “Second Income Plans.”

Senator Long is credited with recognizing ESOPs and incorporating the concept into the Employee Retirement Income Security Act of 1974 (“ERISA”).

The Tax Reform Act of 1986 enacted Section 1042, which allows owners of a C-Corp who sell at least 30% of a company’s shares to an ESOP trust, the ability to defer recognition of the capital gain realized on such sale.

The Small Business Job Protection Act of 1996 introduced S-Corp ESOPs as a tax-preferred vehicle for owning a corporation. An ESOP trust owning S Corp stock enjoys a special exemption from unrelated business income tax under Section 512(e)(3) and is not subject to income tax on the profits allocated to the shares it owns in the S-Corporation. This is a powerful advantage for S-Corp ESOP companies with respect to their business operations, investments, debt reduction, and M&A activities.

The Economic Growth & Tax Relief Reconciliation Act of 2001 enacted a major anti-abuse rule for S-Corp ESOPs, specifically Section 409(p), which had the practical effect of limiting the advantages of S-Corp ESOPs to S-Corps with at least 11 employees.

C. Statistics

A National Center for Employee Ownership (“NCEO”) survey in 2023 released the statistics:¹

- 2021 median participant ESOP account balance was \$80,500.
 - Compared to Americans who have reported a median 401(k) balance of \$30,000.
- 2021 voluntary quit rate of S Corp ESOP respondent companies was 11.4%.
 - Compared to a National average of 32.7%.
- 2021 average involuntary separation from service rate of S-Corp ESOP respondent companies was 3%.
 - Compared to a National average of 11.6%.

A Project Equity article citing a 2019 study published by the Rutgers Institute for the Study of Employee Ownership and Profit Sharing provided the following statistics:²

- Employee-owners of color earned an average of 30% higher pay than non-employee-owners in similar roles.
- ESOP companies were 50% less likely to lay off employees in the previous two recessions.
- ESOP companies were 50% less likely to go out of business over a 10-year period than traditionally owned businesses.

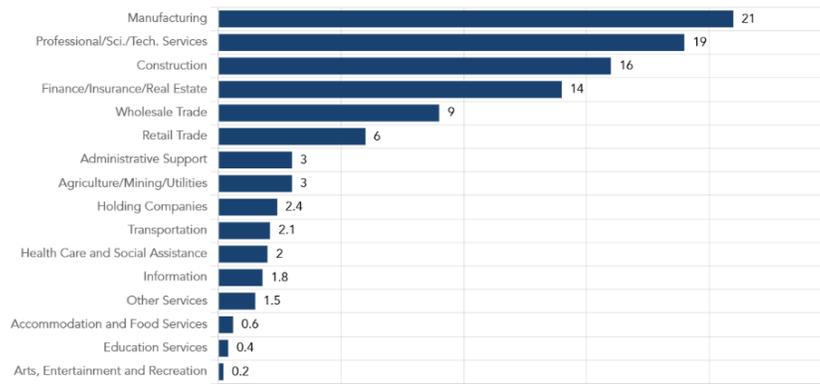
¹ See <https://esca.us/studies-and-surveys/nceo-study-finds-employee-ownership-provides-significant-advantages-in-uncertain-economy/>

² See <https://project-equity.org/news/employee-ownership-insider/how-esops-can-help-to-close-the-racial-wealth-gap-and-promote-economic-justice/>

The NCEO published “Employee Ownership by the Numbers,” which drew from data made available by the U.S. Department of Labor and other sources, provided the following statistics about ESOPs:³

- Total ESOP Plans as of 2023 – 6,574
- Total Assets held in ESOP Plans as of 2022 – \$1.8 trillion
- Total Participants in ESOP Plans as of 2022 – 14.9 million

Industries of ESOP Companies:



D. Structure of an ESOP

An ESOP is established and maintained by a corporation. In some cases, only one corporate entity (the operating entity) sponsors the ESOP. In many cases of an S-Corp, a parent company is the plan sponsor and its various Subchapter S Subsidiaries and its wholly owned LLCs are participating employers in the plan. This structure is important if the company is acquisitive in nature, desires different participating employers in the plan (union/non-union), or wishes to isolate business risk arising from certain industries or product/service lines.

In the case of a 100% ESOP owned company, there is only one shareholder of the company, the ESOP trust. ESOPs can own as little as one share, but this is rare. In the case of a partial S-Corp ESOP with several other owners, it is important to note that the S-Corp rules still apply, including: the limitation on the number of shareholders (100), and the single class of stock rules. In certain industries such as engineering firms, ESOPs can be valuable for entities that want to maintain S-Corp status but are close to exceeding the 100-shareholder limit.

The majority of ESOP sales involve a larger sale transaction to the ESOP. If an owner is interested in forming an ESOP for his or her employees but only wants a small percentage

³ See <https://www.nceo.org/research/employee-ownership-by-the-numbers>

of ownership to be held by the ESOP, a contributory ESOP is a viable option. The company could redeem some shares of the owner(s), hold them in treasury, and contribute them to the ESOP trust at a desired, but discretionary, benefit level annually. A contributory ESOP incurs significantly less cost in professional fees but typically results in a lower benefit to employees and reduced tax benefits compared to an ESOP owning a higher percentage of the stock of a corporation.

The following relate to the structure and governance of an ESOP:

- A trustee of the ESOP trust is appointed to represent the participants of the ESOP. The board of directors of the company (or the managing members in the case of an LLC taxed as a corporation) appoints the trustee. This appointment should occur as soon as possible after the shareholders have decided to establish the ESOP.
 - Internal or non-independent trustee: A company employee, board member, or shareholder can serve as the ESOP trustee. While this is more common in smaller companies, minority-owned or highly mature ESOPs may face potential conflicts of interest that warrant careful consideration.
 - External or independent trustee: Alternatively, there are professional individuals or institutional trustees who undertake the fiduciary obligations of the ESOP trust and represent the interests of the employees. Their extensive experience with ESOPs can be crucial for newly formed ESOPs along with the removal of any conflicts of interest.
- The selling shareholder(s), with assistance from the company's financial advisor, negotiates the selling price of the shares to be purchased by the ESOP trustee on behalf of the ESOP trust. In an ESOP transaction, the ESOP trust must not pay more than adequate consideration (i.e., fair market value) for the shares acquired.
- The ESOP trustee has a fiduciary duty to monitor the board's activities and has the power to exercise the right, as a shareholder of the company's shares, to vote on the removal or appointment of board members.
- Regular board of director meetings—held at least annually—and their documented minutes are essential to demonstrate the board's proper fulfillment of its fiduciary responsibilities, distinct from those carried out by company management or the board of directors. The purchase of shares by the ESOP is typically financed through both external financing, likely senior bank credit, and subordinated seller notes.
- An internal loan is typically made by the company to the ESOP trust. In these cases:
 - The ESOP does not have cash at its inception.
 - The ESOP trust issues a note to the company equal to the amount borrowed to purchase the shares.
 - In order for the ESOP to repay the principal and interest on the note, the company must make annual contributions of cash to the ESOP trust. The ESOP trustee then uses the cash to repay the principal and interest on the note due to the company.

- This amount is shown as ESOP Non-Cash Compensation Expense on the company's income statement but added back on the statement of cash flows to reflect its circular, non-cash nature.
 - The internal loan does not appear as a liability or asset on the company's balance sheet. Instead, the loan is included in the equity section as a "contra-equity" account.
 - The amortization of the internal note sets the scheduled release of shares from the ESOP's suspense account to participant accounts in the ESOP over time.
 - Focus on the amortization period of the internal note has increased over the past decade given repurchase obligation pressures.
 - If shares are released too quickly, participant ownership may become overly concentrated, increasing the risk of a repurchase obligation bubble. A have/have not situation can also occur if no shares are available for future employee-owners.
- Company contributions to the ESOP are capped by the deduction limitation of Section 404(a)(3) and indirectly by the limitation on annual additions to a defined contribution plan under Section 415(c). See Section 404(j)(1)(B). These limitations apply to contributions made to all defined contribution plans.
 - The maximum annual deductible contribution to defined contribution plans is 25% of the eligible compensation paid during the taxable year to participants of the plans.
 - Contributions by a C corporation used to pay interest on the internal loan is not subject to the 25% deduction limit; therefore, C Corporations have greater flexibility in making ESOP contributions that are used to repay internal loans.
 - The maximum annual addition under Section 415(c) is the lesser of 100% of the participant's compensation or a statutory dollar limit (\$70,000 for 2025) that is adjusted annually for inflation.

E. ESOP Myths

1. My employees do not have the money to buy the company stock.

- Employees do not purchase the stock, rather the company makes corporate tax-deductible contributions to fund the ESOP, or the ESOP can borrow the money to buy the stock.
- ESOP transactions can be structured where, in addition to the ESOP's purchase of shares, employees are granted options, such as incentive stock options, to purchase shares with their own funds; however, this is relatively uncommon.

2. The company will have to make fixed contributions every year to the plan.

- If the ESOP has a loan from the company, yes, a fixed annual contribution is required to be made to the ESOP to fund at least the repayment of the principal and interest on the internal note. However, for leveraged ESOPs this is a round-trip contribution that does not impact the net cash of the company, as the contribution is used to repay the internal note.
- In connection with the repurchase of shares allocated to participants' accounts in the ESOP as needed for distributions or diversification, the company can pre-fund this obligation by making additional cash contributions to the ESOP.

3. My employees will not have diversification of their retirement assets.

- Many companies continue to offer a 401(k) plan to provide diversification of retirement assets.
- As participants reach retirement age, Section 401(a)(28) mandates that participants after reaching 55 years of age and completing 10 years of participation in the ESOP have the right over a 6-year period to diversify up to 25% of the shares allocated to their account each year for 5 years, and 50% of the total number of shares allocated to their account in the sixth year.

4. I will have to share sensitive financial data with my employees.

- The only financial data required to be shared is the financial highlights of the benefit plan's performance (not the company's). This is public information found on the Form 5500 filed annually on account of the ESOP.
- Participants receive a statement annually of their account value. This statement shows the number of shares allocated to their individual account, the share price, and their vested account balance.
- No financial statements or details around the valuation are required to be shared with participants.
- One of the benefits of an ESOP is increased employee engagement and motivation tied to company performance. Some companies choose to participate in open book management, sharing key areas of the financials; however, salaries are typically not shared.

5. I will lose control of the company.

- If shareholders are selling more than 50% of the shares of the company, then yes, the ESOP trustee who is the legal shareholder has voting control over the company. If shareholders are being paid a control premium when selling their shares, the U.S. DOL expects that the ESOP trustee will have elements of control post-transaction that includes the right to elect directors to the board and the right for independent board members to sit on the board.

- Owners who decide to sell to an ESOP usually have the admiration of their employees and, to the extent the employees do not want the owners to quickly exit the business, the owners remain in management and run the business the same way they were able to be successful pre-transaction. This is accomplished by the former shareholders remaining on the board post-transaction for as long as they are adding value. The board's responsibility, among others, is to hire the executive management team and set the strategic direction of the company.
- Some owners do have to understand that running questionable personal/business expenses through the business and extravagant spending will need to cease.

6. I will never be able to sell again.

- When looking at the overall number of ESOPs, despite growth in new ESOP creation, the net number of ESOPs is relatively constant.
- ESOPs have a life cycle. Tremendous growth, burdensome repurchase obligations, and capital requirements are all reasons ESOP companies sell to an unrelated buyer.
- In some cases, ESOPs are looked to as an alternative to other buyers when the M&A market cycles downward. Owners who still want to monetize, will sell to the ESOP (obtain warrants in the original ESOP transaction), and then exercise the warrants and sell the company again once the market rebounds.
 - Financial buyers look at ESOP companies regularly because the Form 5500 provides the fair market value of the company, giving the buyer a starting point in negotiations.

F. ESOP Candidates

1. Culture and Selling Shareholder

The culture, current management styles and motivations of the selling shareholders play an important role in the ongoing success of the company post-transaction.

- A culture of empowerment and growth for employees at all levels with succession as a key element of strategy.
- Desire to maintain the company's legacy.
- The company and owner are key fabric of the local community.
 - Protect jobs and increase benefit to employees.
- Amenable to not obtaining strategic value for the company.
 - ESOPs must not purchase for more than fair market value.

- Potentially not exit the business immediately
 - Management and Executive structure does not need to change.
 - Only board composition must experience a change.
- In most cases, the owner must be willing to retain some risk tied to the business for a period of time given the need for a subordinated seller note to make up the debt structure.

2. **Company Characteristics**

As a result of the 2001 EGTRAA legislation, ESOPs must comply with various year-end testing requirements. Additionally, as an ESOP matures, repurchase obligations of the participants who terminate/retire/diversify impact cash flow. As a result, it is important that the company meet certain characteristics.

- Adequate number of employees. The range can vary depending on turnover, but 20-50 employees is the practical minimum. The minimum size is necessary to avoid Section 409(p) and keep the S-Corp ESOP a qualified plan.
 - Sufficient numbers to prevent any one participant from having too large of a percentage and sufficient eligible payroll to support needed contributions to the plan.
 - 409(p) – The anti-abuse test for S Corp ESOPs. Ensures a broad base of rank-and-file employees participate in the plan.
 - 404 Limits – Limits on annual contributions to the plan.
- Minimum EBITDA. The range can vary based upon several factors. Despite the tax benefits, considerations such as debt service from 100% leverage, future repurchase obligations, and ongoing professional fees make it advisable that the company generate at least \$2m in EBITDA.
 - This is not to say an ESOP cannot have a lower normalized EBITDA.
- Stable earnings and cash flow
 - Construction companies are a large share of ESOP-owned companies. Despite the construction cycles, retention of cash and a strong balance sheet are key to mitigate these fluctuations.
- Collateral Support
 - Sufficient assets allow for more senior financing and less seller debt.
 - An ESOP can be financed by 100% seller financing if needed.

- Turnover
 - ESOPs can be used to assist in employee retention.
 - In industries where high turnover cannot be reduced by the ESOP incentive, record keeping of employees/participants is more burdensome.
- Union workforce
 - Union labor can either be excluded from or participate in ESOPs.
 - In most cases, union employees are excluded because they want to maintain their position as an employee – not an employee-owner.
 - In the case of a holding company, multi-entity structure with union and non-union entities, one must evaluate the solvency of the union pension plan and unfunded liability/withdrawal liability that could be incurred.
- Corporate Governance, Records, Financials
 - As with positioning a business for any sale, the company must have reliable financials and business records.
 - Many family-owned businesses do not have detailed governance processes. A willingness to adapt is essential given the entrance of an independent trustee, a majority of independent board members, and oversight by the U.S. Department of Labor.

II. Planning for a Sale

A. Estate Planning

An ESOP can be a powerful tool for selling shareholders to transition ownership of their company and create liquidity used to transfer wealth to their heirs on a tax-favorable basis. A sale to an ESOP can significantly reduce estate tax liabilities and can be used to fund irrevocable trusts, charitable foundations or other tools that may reduce estate taxes. If the company is a C Corporation, the selling shareholders may be eligible to make an election under Section 1042 to defer tax on the gain from the sale (see below for more information on the Section 1042 election). An ESOP is a great tool to help preserve a company's culture, independence and family legacy.

1. Preliminary Planning

- Clarify Goals
 - Do the selling shareholders want to preserve the company's culture and independence?
 - Do the selling shareholders want to retain control of the company while planning a full exit?

- Do the selling shareholders intend to make an election to defer tax on the gain from the sale under Section 1042?
- Decide on Type of Sale.
 - A partial sale (less than 50%) provides some liquidity but would allow the selling shareholders to retain control of the company. A partial sale is useful for a gradual exit by the selling shareholders, business continuity and for providing a ramp-up period for building an ownership culture.
 - A full sale provides maximum liquidity and would allow the selling shareholders to make a complete exit from ownership and potentially management. A full sale shifts complete control of the company to the ESOP trustee and employee-participants. This approach requires strong governance and a definite internal succession plan.
- Inform Key Family Members and Align Interests. Communication of plans to sell to an ESOP with key family members is crucial to preserve relationships, align the interests of all parties and ensure that the sale meets all parties' goals. Lack of transparency can lead to disputes and potential governance issues after the sale.
 - The selling shareholders should communicate to their key family members regarding the financial and strategic goals for the sale (e.g., maintaining the company's culture and independence, supporting the family's legacy).
 - Any existing conflicts among key family members should be resolved before the sale occurs.
 - Family members should understand how the sale will affect their inheritance, control and future involvement in the company.
 - Communication is important to manage expectations and clarify roles and financial outcomes for each family member, whether active in the business or not.
- Determine Roles Post-Sale.
 - Succession plans for company management should be clearly communicated after consideration of family dynamics and the company's business strategy.
 - Roles should be assigned to family members based on competence and leadership ability.
 - The company should establish clear board roles, voting rights and oversight responsibilities.
 - The company should establish a plan for how family members will interact with the ESOP trustee and other employees.

- Prepare for Financial Windfall and Lifestyle Adjustments.
 - The selling shareholders and their heirs should establish a team of advisors with expertise in ESOPs (e.g., estate planning, tax and financial advisors) to assist with the financial windfall associated with the sale of the company to an ESOP, particularly if the selling shareholders make an election under Section 1042.
 - The selling shareholders should discuss the windfall and their estate plan with their heirs to avoid any surprises.

2. Tax & Legal Readiness

- Review and Update Estate Plan / Trusts.
 - Prior to a sale to an ESOP, the selling shareholders should review all wills, trust agreements and other relevant legal documents, and beneficiary and asset title designations to ensure that those documents or designations reflect their intentions.
 - The selling shareholders should consider utilizing special trusts or other legal entities to shift value from their estate prior to the sale.
- Tax and financial implications of sale.
 - The sale may require seller financing which affects the selling shareholders' risk exposure.
 - The company must plan for the repurchase obligation when participants become eligible for distributions from the ESOP, which impacts the company's cash flow and valuation.
 - If the company is a C corporation, the selling shareholders may elect to defer tax on the gain from the sale if certain requirements are met.
 - The ESOP must own at least 30% of the company after the sale.
 - The shares that are sold to the ESOP must have been held by the selling shareholders for at least 3 years prior to the sale and not acquired pursuant to stock options, as restricted stock, as compensation or from a retirement plan.
 - The selling shareholders will not be eligible to participate in the ESOP and certain lineal descendants of the selling shareholders may only participate in the ESOP on a limited basis.
 - The selling shareholders must reinvest the proceeds in "qualified replacement property" ("QRP") (generally, U.S. stocks or bonds of operating companies) within 12 months following the sale.

- If the QRP is held until the selling shareholders' death, the tax on the gains from the ESOP sale is eliminated.
 - The selling shareholders may borrow against the QRP for liquidity without destroying the tax deferral opportunity.
 - If the company is an S corporation prior to the sale, the company can revoke the S corporation election so that the selling shareholders can qualify for the Section 1042 tax deferral. The company can convert back to an S corporation five years following the initial conversion from an S corporation to a C corporation.
- If the company is an S corporation, the selling shareholders are subject to capital gains tax on the proceeds from the sale. Beginning in 2028, the sale of S corporation stock to an ESOP is eligible for Section 1042 tax deferral but only up to 10% of the proceeds.

B. Preparing Your Business for Sale

Selling a business is a complex and personal process that requires thoughtful preparation. Business owners can reduce stress and maximize value by taking proactive steps well in advance of a sale.

Clarify Personal and Financial Goals

Understanding the owner's long-term objectives is essential. These goals shape the structure of the transaction and influence decisions about future involvement, employee impact, and buyer selection.

Evaluate Leadership and Succession Plans

A strong, informed management team is critical, especially if the owner plans to exit immediately. Buyers will assess leadership continuity and the risk of losing institutional knowledge. Typically, in an ESOP transaction, the selling shareholders receive some seller notes as consideration in the transaction. These notes typically range from 50% - 100% of the purchase price in a 100% ESOP transaction, and as such the selling shareholders typically go from the largest equity holders to the largest debt holders. If they intend to step away from the business quickly, a strong management team is critical.

Strengthen Financial Reporting

Accurate, well-maintained financials are key to valuation. Reviewed or audited statements, or a quality of earnings report, can build buyer confidence. Companies should also assess internal systems, reporting capabilities, and the strength of their finance team.

Review Real Estate Holdings

If the business uses shareholder-owned real estate, determine whether to include it in the sale. Fair market rent studies and separate financials for real estate entities can help structure a tax-efficient and smooth transaction.

Engage Key Stakeholders Early

Notify banks, insurers, bonding companies, and major clients early to avoid disruptions. Review contracts for change-of-control clauses or other contractual covenants that may be triggered by a sale.

Position for Strong Valuation

Buyers favor businesses with recurring revenue, diverse customer bases, and stable cash flows. EBITDA is the primary valuation metric, so minimizing nonrecurring expenses and personal add-backs can improve perceived value.

Address Industry-Specific Regulations

In regulated industries, ownership and licensure requirements must be considered across all operating states, as well as jurisdictions that may be part of the company's short-term growth plans. Early legal and tax guidance is essential.

Assess Compensation Structures

A compensation study can ensure salaries are market-aligned. Adjustments may impact EBITDA and valuation, so aligning incentives pre-sale is important.

Start Early, Stay Flexible

Early planning allows time to address issues and improve outcomes. Even if a sale is delayed, the preparation adds long-term value. Advisors can help identify action items and guide owners through strategic liquidity options, including third-party sales, ESOPs, or family transitions.

Once the company is ready for a sale, the next step is to assess what type of transaction works best for all parties. A Review of Strategic Alternatives Analysis can help assess which options meet the goals of the shareholder(s) or the company. If the company is focused on an ESOP transaction, they can perform an ESOP Feasibility Study for more a more specific assessment.

Preparation Process

An initial ESOP Feasibility Study should address a very simple question. **Does an ESOP make sense given company and shareholder goals?** A Feasibility Study can be an iterative process providing clarity on different structure alternatives.

1. Scope

- Review the historical financial performance of the company, analyze its debt capacity and historical normalized cash flow, perform a series of valuation models that yield an approximate range of value for the company, and then model what the implications and transaction structure would be if the company installed an ESOP across the range of values.
- Analyze and assess the ability of the company in future years to service debt and meet equity requirements related to the ESOP transaction, while continuing to fund the on-going operation of the business, based on assumptions agreed upon by management.
- Model the pre- and post-tax proceeds to selling shareholders.
- Model estimated Management Incentive Plan payouts and ESOP Share allocation and account balances for a sample of participants.
- Provide a proposed ESOP transaction structure including an outline of the transaction, board governance issues post-ESOP, and related issues of the ESOP transaction.
 - C Corp vs. S Corp
 - 100% Sale vs. Minority ESOP
 - Collaborate with tax professionals on tax restructuring, if needed.

2. Timeline

- Due Diligence and Summary Valuation
 - Two to three weeks from receipt of diligence items
- Scenario Modeling, Plan Design and Corporate Restructuring Considerations
 - Two to three week timeline
- Present Scenario Models
 - Determine if any iterations of the models are needed.
 - If an ESOP is the right fit for the company, the shareholders, and the employees, the feasibility study will serve as the roadmap for the transaction.

Transaction Preparation

Once the decision is made to pursue an ESOP, the next steps are:

- Engaging relevant service providers, i.e., company financial advisor and legal advisor.
- Start preparing and collecting relevant documents and records.
- Hold initial discussions with key stakeholders, lending partners, regulatory/licensing agencies, bonding companies, insurance carriers, etc.
- Consider financial reporting of the company and determine if enhanced financial due diligence is necessary (reviewed or audited financial statements, quality of earnings study, etc.).
- Solicit request for proposals to help determine the ESOP trustee who will represent the employees in the negotiation of the transaction.
- Complete any necessary entity restructuring that may be necessary (including holdco, consolidation of entities, choice of entity (C or S corporation), inclusion or exclusion of real estate or other “unwanted” assets, etc.).
- Perform valuation / market rent studies on real estate and other property included in the transaction.

III. The Transaction

Company	ESOP	Shareholders
Financial Advisor	ESOP Trustee	Financial Advisor (Opt.)
Legal Advisor	Trustee’s Financial Advisor	Legal Counsel (Opt.)
Tax Advisor	Trustee’s Legal Advisor	
CPA		

Legal Advisor

The Legal Advisor represents the company in the sale of the stock to an ESOP. The legal advisor’s role is to ensure that the transaction is transparent, legally sound and beneficial to all parties involved. The legal advisor works closely with the company’s financial advisor in structuring the transaction to ensure compliance with relevant laws and regulations. The legal advisor drafts and reviews all of the transaction documents, manages the due diligence process and negotiates with the ESOP trustee and its legal advisors.

Transaction Advisor

The transaction advisor acts as the financial advisor, or deal orchestrator, to the company in its transition to sell to an ESOP. As the deal orchestrator, the financial advisor manages and negotiates all aspects of the deal to a successful realization.

A. Structuring the Transaction

1. Redemption then Sale or Direct Sale of Shares?

Typically, an ESOP transaction is structured either as a redemption of the company's stock from the selling shareholders followed by a sale of the company's stock to the ESOP by the company or as a direct sale to the ESOP by the selling shareholders.

Redemption Followed by a Sale. Under this structure, the company purchases all or a portion of the selling shareholders' company stock. The redemption transaction is typically funded with bank debt obtained by the company and/or seller financing (see below for more information). The redemption transaction is immediately followed by a sale of the stock by the company to the ESOP.

- Advantages
 - The ESOP trustee negotiates the purchase of the company's stock with the company versus the selling shareholders which may reduce fiduciary complexity and avoid potential conflicts of interest between the trustee and the selling shareholders.
 - The redeemed shares can be sold to the ESOP pursuant to a promissory note with a longer term which will allow the company to spread out allocations over a longer period.
- Disadvantages
 - The redemption followed by a sale to the ESOP by the company is more complex from a legal and tax perspective.
 - The redemption transaction must comply with state corporate law which could subject it to shareholder approval requirements and solvency tests.
 - The redemption could be reclassified as a constructive distribution or trigger dividend treatment if the transaction is not structured correctly.
 - The redemption may affect the company's earnings and profits which may have unfavorable tax consequences.
 - The redemption transaction is not eligible for Section 1042 tax deferral treatment by the selling shareholders.
 - The redemption may raise concerns about self-dealing and manipulation of share value.

- The redemption followed by the company's sale of stock to the ESOP can raise fiduciary concerns under ERISA, particularly if the redemption affects valuation or control.

2. Direct Sale to the ESOP

Under this structure, the ESOP purchases the company's stock directly from the selling shareholders. The transaction is financed with a loan from the company to the ESOP.

- Advantages
 - The direct purchase is more straightforward and less complex from a legal and tax perspective than the redemption followed by a sale to the ESOP by the Company.
 - It is easier to demonstrate that the ESOP is not paying more than fair market value for the company's stock and fiduciary compliance.
 - The direct sale by the selling shareholders to the ESOP may qualify for deferral of tax under Section 1042.
 - Both the redemption followed by a sale to the ESOP by the company and the direct sale to the ESOP structure must meet the adequate consideration requirement but direct sales are more likely to comply with regulatory expectations.
- Disadvantages
 - The proceeds from the sale are taxed at capital gains rates unless the transaction qualifies for Section 1042 tax deferral.
 - The ESOP trustee must apply vigorous oversight and diligence related to the valuation.

3. Valuation, Pricing, Capital Structure

The ESOP is allowed to pay no more than fair market value for the company. In the redemption followed by a sale transaction described above, both the redemption price paid by the company and the price paid by the ESOP should not be more than fair market value. Fair market value for a private company with no readily available market is based on the trustee's financial advisors' analysis and a good faith negotiation between the company/shareholders and the ESOP trustee. The trustee's financial advisor will perform a similar valuation to what the company's financial advisor completed in the feasibility study. This often includes looking at public companies, recent M&A transactions, and running a discounted cashflow analysis on the company's projections.

These negotiations are undertaken by a non-binding term sheet that is typically first submitted by the sell (company) side. This term sheet will have all the relevant deal points and will serve as a reference to the buy side as to what structure the

company is looking for. After the first offer is submitted, it typically takes the trustee team several weeks to complete their diligence and provide their first counteroffer. Over the course of several weeks, all the relevant deal points will be negotiated until both parties agree.

Most selling shareholders prefer to diversify what might be their largest financial holding (that is likely illiquid) by receiving a portion of the transaction consideration in the form of cash (which is typically borrowed from a financial institution). Working with an experienced financial advisor and ESOP Lending Partner is crucial for determining the appropriate amount of leverage that provides a sufficient down payment to the selling shareholders without overburdening the company with too much transaction leverage. Most ESOP transactions are financed with term loans, including scheduled amortization and any possible excess cash flow pre-payment to repay debt quickly. Companies with collateral (real estate, working capital, etc.) might end up in a structure with a longer-term mortgage or revolving line of credit, which reduces the scheduled debt service. (Note that in most ESOP transactions, the company is the borrower, not the selling shareholders).

4. Seller Note and Warrants

As mentioned above, 100% ESOPs are typically financed with senior credit from a bank or alternative credit provider and seller notes. While the bank and the company will negotiate the terms of the senior financing, the seller notes are negotiated as part of the transaction. A few of the key negotiating points are:

- **Term:** While heavily dependent on the industry and company, most companies will be able to repay all transaction debt between 6-10 years from closing. To provide maximum flexibility, seller note terms tend to fall between 12-15 years. While 15 years may seem like a long period of time, it is typical for the company to be incentivized to repay transaction debt much quicker than the stated term.
- **Interest Rates:** Typically, seller notes are subordinated to any senior credit facilities and pay interest only while the senior facilities are outstanding. Due to the subordinated nature of the seller notes, they should receive a return consistent with what a subordinated mezzanine provider would offer. This is based on current market rates but typically low to mid-teens. While this rate of return could be paid in cash, it is typically too burdensome for the company to pay the full amount in current interest payments, which limits the debt capacity when borrowing from a Senior Lender as well. Additionally, while paying full current interest payments create a significant amount of cash flow for the selling shareholders, the interest payments are taxed as ordinary income. To address this, sellers often agree to a below-market interest rate in exchange for detachable warrants.
- **Warrants:** In some transactions, warrants are issued to achieve the same rate of return but in a more cash and tax efficient manner. It is up to the selling shareholder to determine the most attractive split between warrants and interest paid in cash and for the financial advisor to help negotiate this. A minimum interest rate (typically equal to the long-term applicable federal rate) is

required to avoid adverse tax consequences. The extent of warrant dilution depends on the company's projected growth and the targeted level of interest payments.

- If the company is an S corporation and thus only permitted to have a single class of stock, warrants must be structured carefully to avoid the potential creation of a second class of stock. If the strike price for the warrants is substantially less than the fair market value of the company's stock on the date the warrant is issued and the warrant is substantially likely to be exercised, the warrant is treated as equity which violates the single class of stock rule applicable to S corporations. Generally, if the strike price of the warrant is at least 90% of the fair market value of the company's stock on the date of issuance, the warrant is not treated as a second class of stock. Warrants that have preferred rights or that are used to manipulate ownership or control may also be treated as a second class of stock.

B. Bank Financing

Most ESOPs are financed with some combination of bank financing, mezzanine financing, and seller notes. While all are possible, the size of the company, the percentage sold, and the selling shareholders objectives will impact what the optimal structure is.

1. Preparation & Planning

- Draft the Confidential Information Memorandum (CIM).
- Compile Lender Outreach List.
- Discuss and approve NDA in conjunction with legal counsel.
- Draft a "Teaser" which provides a company overview on a no-name basis.

2. Lender Outreach

- Initial high level discussions with banking partners to gauge interest
 - The transaction advisor will sometimes call several bankers to get an early read on the appetite for the subject company based on size, EBITDA, industry, and banking environment before a CIM and proposed structure is put to paper.
- Share CIM with Lenders under NDA
 - In most cases, once a CIM is completed, it is sent to several banks for an auction process to compete on best structure, rate, and cash at close. Some transaction advisors indicate a preferred structure, others ask the banks to compete on what they interpret as best structure.
- Bank Diligence

- While the CIM offers key insights for the bank's credit evaluation, the bank will still perform independent due diligence, much like the ESOP trustee.

3. Lender Selection

- Lender Interviews
- Term Sheet Negotiations
 - There are many different factors to consider in a term sheet including:
 - Loan size
 - Senior leverage profiles typically vary from 1.0x-3.0x EBITDA based on size, industry, balance sheet strength and other factors.
 - Term/Amortization
 - Five-year term and five-year amortization is typical with seven and even ten years possible depending on company creditworthiness.
 - Interest Rate
 - Interest rates are typically floating based on SOFR and can vary from 100-400bps based on the factors above.
 - Covenants
 - Fixed Charge Coverage Ratios of 1.1x to 1.4x depending on the company.
 - Leverage ratios to govern the level of debt compared to company earnings.
 - Cash Flow Sharing
 - Most cash flow-based loans will require some degree of excess cash flow prepayments. These prepayments will typically range from 50-75% of excess annual cash flow and will accelerate the repayment of the loan.
 - Some transactions and lenders allow for seller note amortization at certain performance or leverage points during a transaction.
 - Experience with ESOP-owned companies
 - ESOPs create some unusual financial impacts to the company's income statement and balance sheet (unearned ESOP shares, negative equity, non-cash ESOP expenses, etc.). Having a lending

partner that understands the financial impact that an ESOP creates is a critical component when picking a lending partner.

- These factors along with how the loan is structured can all impact what the best option is for each individual client. A few additional structuring considerations to consider are:
 - ABL/Cash Flow
 - Revolver versus Term
- The most attractive term sheets should be modeled to determine the best options for the company and selling shareholders.
- Lender Partner Selected
 - While the terms of the senior financing are important, the lender will also want to be the company's banking partner for their operating and treasury accounts. It is crucial that the credit provider can meet the company's needs in all banking aspects, not just through the credit facility.

4. Closing

- Final Credit Approval
- Credit Documents
- Transaction Funding

C. Documentation and Legal Considerations

An ESOP transaction requires execution of a comprehensive set of documents to finalize the transaction, ensure legal compliance and establish the ESOP plan. These documents are heavily negotiated by the parties.

- **Stock Purchase Agreement:** The stock purchase agreement and/or stock redemption agreement describes the terms of the sale/redemption. The agreement sets forth the purchase price, any post-closing adjustments to the purchase price, representations and warranties by the parties and related survival periods, indemnification provisions, escrow requirements and closing conditions. Common representations and warranties in the agreement might include the following:
 - **Authority:** The company, the ESOP trustee and the selling shareholders represent that they have the authority to enter into the transaction.
 - **Capitalization:** The company represents that it has provided an accurate disclosure of the capitalization of the company.
 - **Financial Statements:** The company represents that its financial statements fairly present the company's financial condition and are prepared in accordance with GAAP.

- Taxes: The company represents that it has filed all tax returns and there are no undisclosed liabilities or audits pending.
 - Material Contracts: The company represents that it has disclosed all key agreements, which will vary depending on the industry (e.g., customer, vendor, loan and lease contracts).
 - Compliance With Laws: The company represents that it is in compliance with applicable laws and regulations.
 - Litigation: The company represents that it has disclosed all active and threatened legal actions.
 - Specialist Representations: Includes disclosures regarding intellectual property (ownership and protection of intellectual property assets), employment matters (employee benefits, compensation, employment actions, labor disputes), environmental matters (compliance with environmental laws and disclosure of any known issues).
 - No Material Adverse Change: The Company represents that no significant negative changes have occurred since the lookback date specified in the agreement.
 - ESOP-Specific Representations: The Company represents that the ESOP meets the requirements to be an ESOP under ERISA and the Code; the securities purchased by the ESOP are qualifying employer securities as defined in ERISA and the Code; no non-exempt prohibited transactions have occurred; the ESOP has been administered in compliance with ERISA and the Code; if the company is an S corporation, no violations of Section 409(p) have occurred (the anti-abuse statute applicable to ESOPs).
- ESOP Plan Document: The ESOP plan document governs the operation and administration of the ESOP. The plan document must comply with ERISA and the Code.
 - ESOP Trust Agreement: The ESOP trust agreement governs the relationship between the ESOP trustee and the company sponsoring the ESOP, including setting forth the ESOP trustee's duties, the company's obligations and the indemnification provisions applicable to the relationship.
 - ESOP Loan Documents: If the company makes a loan to the ESOP to finance the transaction, the loan will be documented by an internal loan and pledge agreement which describes the terms of the ESOP loan and the security for the loan, an internal ESOP promissory note and an amortization schedule for the loan.
 - Fairness Opinion: The fairness opinion is issued by the ESOP trustee's financial advisor and confirms that the purchase price for the company's stock is not more than adequate consideration and that the transaction is fair to the ESOP from a financial point of view.
 - Company Board Resolutions: The board resolutions will authorize the transaction and approve the adoption of the ESOP and appointment of the ESOP trustee.

- **Legal Opinions:** Company counsel and the ESOP trustee's counsel typically provide certain legal opinions regarding the enforceability of documents and compliance with applicable laws.
- **Stock Certificates:** On the closing date, the Company will issue stock certificates to each shareholder reflecting the number of shares owned. If the sale to the ESOP is 100%, one stock certificate will be issued in the name of the ESOP trust. If the sale to the ESOP is less than 100%, stock certificates will be issued in the name of the ESOP trust and each other shareholder. The stock certificate issued to the ESOP trust representing the shares that are held in the ESOP but are not yet allocated to participants serves as collateral for the ESOP loan.

If the transaction is funded by a third-party lender, the negotiation of the credit agreement between the lender and company's legal team requires an additional level of review given the needed ESOP provisions. With an ESOP-owned company, the lender will focus on the cash outlay required for the company to make contributions to the ESOP to fund payments on the internal loan and distributions to participants. Typically, contributions to an ESOP are not permitted under the credit agreement unless there is an exception permitting such payments. Most credit agreements will permit the company to make contributions to the ESOP to fund repayment of the internal ESOP loan. In addition, contributions to fund the company's repurchase obligation under the ESOP are also typically permitted, provided that the payments would not result in an event of default or other covenant default under the credit agreement. If the company were to find itself in a situation where contributions to the ESOP to fund repurchase liability payments would result in a default or breach of a covenant under the credit agreement, the company would have to approach the lender to discuss alternatives. Some third-party lenders require an assignment of the ESOP loan documents as collateral under the credit agreement. If that is the case, the lender will prepare a Collateral Assignment Agreement and the lender will hold the stock certificate for the shares of stock pledged as collateral under the ESOP loan.

The credit agreement between the lender and the company will also include certain notice and reporting requirements with respect to the ESOP. Typically, the company will be required to provide copies of the annual Form 5500 submitted for the ESOP, the annual valuation report (typically subject to the lender's execution of a non-reliance agreement in favor of the ESOP trustee's financial advisor) and the annual Section 409(p) test results if the company is an S corporation. The credit agreement may also require lender consent for any amendment to the ESOP or any related document that would be adverse to the lender.

D. Closing

All legal and other transaction advisors are focused on ensuring all aspects of the deal have been properly documented and all necessary items are in place prior to final signatures and closing.

Legal Advisor

- **Document Review:** Reviewing all documents to ensure the final documents are complete and accurately represent what was negotiated in the term sheet.
- **Coordinate Execution of Documents:** Arrange for execution by all parties, including the selling shareholders, the company, the ESOP trustee and the lenders.

- **Legal Compliance:** Confirm that the transaction complies with all fiduciary and regulatory requirements.
- **Trustee Coordination:** Ensure that the ESOP trustee has completed due diligence, received the valuation report and issued a fairness opinion; schedule a meeting between the board of the company and the ESOP trustee to document the board's duty to monitor the ESOP trustee.
- **Closing Conditions:** Ensure that all closing conditions are satisfied for all parties.

Company Financial Advisor

- **Flow of Funds:** Ensuring that the cash is distributed to the appropriate parties at closing.
- **Pre-Transaction Distribution:** Depending on the transaction, assisting the company with determining the appropriate amount of cash to distribute pre-transaction.
- **Document Review:** Reviewing all documents to ensure the final documents accurately represent what was negotiated on the term sheet.
- **Insurance:** Working with appropriate insurance advisors to ensure the company and officers have the appropriate D&O and Fiduciary insurance in place at closing.

IV. Post Closing

A. Immediate Post Closing

- **Finalize Documentation:** Fully executed copies of all transaction documents should be finalized, confirmed complete with exhibits attached and held in a closing binder for reference as needed.
- **Manage Post-Closing Adjustment, Escrow Fund and Indemnification Claims:** Within a specified period following closing, the parties will determine and agree to a working capital adjustment to the purchase price. In addition, the parties will monitor the escrow fund for potential expense and liabilities and address indemnification claims related to breaches of representations and warranties if and when they arise.
- **Coordinate with Service Providers:** The company and its advisors will with third-party administrators, recordkeepers and the ESOP trustee to ensure that the ESOP is administered in accordance with ERISA, the Code and the provisions of the ESOP and trust documents. The legal advisor will review and evaluate service agreements with these vendors to assist the company with determining that the terms and conditions are fair and reasonable to the ESOP.
- **Corporate Governance:** The legal advisor will advise on post-transaction governance, including the timing requirements for the appointment of independent directors as negotiated among the parties, and assist with any necessary organizational restructuring as a result of the transaction.

- **ESOP Internal Administrative Committee:** If appointed, the internal ESOP administrative committee should meet regularly to execute its fiduciary responsibilities and document those meetings with minutes.
- **ESOP Accounting:** Most companies have not undergone a sale before, particularly as it relates to an ESOP. After the close, in connection with the company's CPA, the financial advisor will help educate the client on the financial impact of the ESOP on the company's balance sheet both for the transaction itself and on an ongoing basis.
- **ESOP Rollout:** Effectively communicating the implementation of an ESOP to employees is crucial for ensuring their understanding, engagement, and support. A well-planned rollout can help employees appreciate the benefits of the ESOP and foster a sense of ownership and commitment to the company's success. Typically conducted by the company with the support of the Trustee and Financial advisors, this is the first opportunity to educate the employees on the benefits of an ESOP and create excitement around their new role as employee-owners.
- **MIP Presentation:** Negotiated alongside but separate from the ESOP is often a Management Incentive Plan or MIP. This pool of synthetic equity is used to reward and incentivize key members of management. Governed by the board of directors, these plans are often new for most companies. This presentation is useful to help educate the board on this new plan and its key features like grant provisions, vesting schedules, performance hurdles, and payment terms.
- **Stock Certificates:** As the ESOP loan is repaid and shares of company stock held in the ESOP trust are allocated to participants, the shares released to participants are no longer classified as collateral under the ESOP loan. Although the ESOP trust is still the legal owner of all shares held in the ESOP trust, the company will need to issue new stock certificates annually to reflect the number of shares that have been allocated under the ESOP as the internal loan is repaid and the shares that remain unallocated and continue to serve as collateral for the ESOP loan. In, addition, if shares are distributed to participants, the Company will issue stock certificates directly to participants individually.

B. Later Years

- **Sustainability and Repurchase Obligation Studies:** Typically started 3-5 years post close. These studies assess the long-term viability of the ESOP and the company's ability to meet its repurchase obligations. They involve analyzing the company's financial health, projecting future cash flows, and evaluating the potential impact of the ESOP on the company's sustainability.
- **Acquisition Offers:** If an ESOP-owned company receives an acquisition offer, what actions should the company's management and board take? The board should engage the ESOP trustee immediately as the legal shareholder of the company's stock. The ESOP trustee has a fiduciary duty to act in the best interests of participants and must evaluate the offer independently. The ESOP trustee and the company should engage advisors to assist with evaluation of the offer. If the board and the ESOP trustee decide to move forward with the offer and the sale takes certain structures (e.g., merger, sale of substantially all of the assets), participants may have voting rights with respect to the stock allocated to their ESOP accounts. Ultimately, in determining whether a sale

of the company makes sense, the board and the ESOP trustee should consider the following:

- Is the offer in the best interest of ESOP participants?
- Does the offer reflect the fair market value of the company?
- Are there other alternatives that the board and the ESOP trustee should consider (i.e., minority equity sale, sale to a financial buyer, management buyout)?

C. Operating the ESOP-Owned Company

It is important to maintain an independent trustee. Companies who are well advised by ERISA counsel, CPAs, TPAs and valuation professionals often believe after years of process and governance a savings can be made by bringing the trustee role in-house. In connection with administering the ESOP, this mindset is largely true. However, being well advised and administering the ESOP pristinely does not protect the trustee from lawsuits and legal action by a disgruntled participant. The potential for personal liability and/or company expenses from indemnification outweigh any savings and expertise of an independent trustee. Additionally, it is important for an adequate level of fiduciary coverage for the board and officers.

Once the ESOP matures and begins making distributions/rollovers to participants, it is advised to outsource this function to the TPA. Paperwork, funding, reconciling, tax withholding for those not rolling over are worth the cost of the TPA. Further, the DOL, like CPAs, prefer a separation of duties with less cash transactions resulting in less opportunity for fraud.

It is important that the company have a well-qualified controller or CFO once becoming an ESOP. The CFO and HR functions are the two most utilized in administering an ESOP.

In the early stages of the ESOP-life cycle, time allocated for staff is minimal. As the ESOP matures and encounters repurchase obligations, diversifications, and evaluates other strategic goals such as acquisitions, time devoted to the ESOP increases. A sample calendar of responsibilities is below.

D. Key Dates

January

- Compile census for TPA.

February

- Send out eligible diversification notices and election forms.

March

- Board meeting to discuss projections and draft audit.
- CPA file tax extensions.

- Will want cushion given number of advisors needing to complete work.
- ESOP Form 5500 filing extends from July to October.

April

- Meet with valuation advisor -diligence for annual valuation.

May

- Final financial statements and annual valuation.
- Deadline to receive diversification elections.

June

- Fund diversifications distributions.
- Schedule participant event around release of participant statements and stock price.
- Board meeting to formally note review of audit and valuation documenting any issues that came up in in-formal review in May. Discuss cash position for yearend participant distributions.

August

- ESOP Plan Audit – For larger plans
 - Participants of 100 or more with account balances on the first day of the year.
 - There is an exception for plans in the 80-120 range.

September

- Send out eligible termed participant distribution paperwork.
- Notify potential retirees of paperwork deadline.
- Touch base with ERISA counsel for any required plan update language needed prior to year end.

October

- File Form 5500 (with completed plan audit if applicable).
- Deadline to return all distribution paperwork.
- Contact TPA to estimate eligible payroll for the year given Q3 numbers and eligible diversifications for the following year.

- Used to budget for cash contributions to the plan.

November

- Fund distributions.
- Board meeting to discuss year end estimates, following year projections, additional cash contributions to the plan beyond distributions. Review plan audit/5500.

December

- Make required ESOP contribution in conjunction with guidance of TPA and Trustee.

V. Conclusion

In summary, Employee Stock Ownership Plans (ESOPs) offer a unique and beneficial option for ownership transition, providing significant advantages for both the company, its employee, and the selling shareholders. By understanding the structure, planning for the sale, navigating the transaction process, and addressing post-closing considerations, companies can effectively implement and manage an ESOP. The result can be a culture of ownership that drives long-term success for the company and its employees.