



Employee Stock Ownership Plans - ESOPs

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500+
ESOP
transactions



Currently representing
44,000+
ESOP
Participants



Sales of **ESOP**
companies
* **30+**

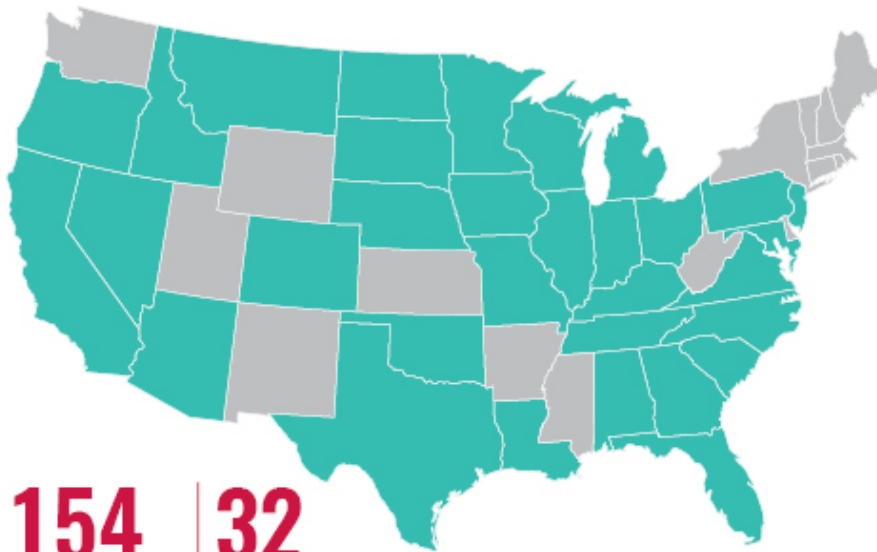


SERVING CLIENTS IN OVER 45 INDUSTRIES



ASSOCIATIONS

- The ESOP Association
- National Center for Employee Ownership
- Ohio Employee Ownership
- Employee-Owned S Corporations



154 | **32**
current ESOP clients | states

17 Trustees
represented in
ESOP
Transactions

Our **ESOP** Transactions
have ranged from
\$1.5M ⇄ **\$1.7**

Since 1985, Krieg DeVault's ESOP Practice, which is part of the Firm's Employee Benefits Practice Group, has structured over 500 ESOP transactions throughout the United States for private and public companies. Our ESOP transactions vary in size up to \$1.7 Billion.

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Why ESOPs

ESOPs are popular for a number of reasons, including their flexibility as a source of liquidity for shareholders without the loss of control over governance or management that or the loss of a company's unique culture that comes with the sale to a third party. Used properly, they are an intricate tool of corporate finance. Likewise, ESOPs can be particularly useful in financing acquisitions, "going private" transactions and spin-offs of subsidiaries.

ESOPs have been the subject of a significant number of studies. The results clearly show that if the employees of an ESOP company are well educated about the ESOP and their responsibilities as "employee owners," the company will outperform its non-employee owned counterparts. ESOP companies generate higher earnings, better safety records, and bring new products and services to market more rapidly, which results in higher stock values.

To encourage business owners to sell some or all of their stock to an ESOP rather than a third party, Congress endowed ESOPs with powerful tax advantages and the ability to borrow money (or issue debt securities) to purchase company stock.

If certain requirements are met, a shareholder who sells his or her stock to an ESOP sponsored by a C corporation can elect to defer taxable gain realized on the sale. Moreover, dividends paid on shares of company stock held by the ESOP, which are used to pay the ESOP loan or paid to participants directly, are tax deductible.

In the case of an S corporation, the company's income attributable to the ESOP's ownership is not subject to income tax. Thus, for example, if the ESOP owns 49% of the company's outstanding stock, 49% of the company's income is not subject to income tax. This tax savings, standing alone, is often sufficient to pay the debt incurred by the ESOP to purchase the shares.

Why a Shareholder Should Consider Selling to an ESOP

Most shareholders of private companies ultimately face the dilemma of how to convert their equity to cash or diversified investments. Many owners are wary of selling to strategic or financial buyers due to the inevitable changes in the company's culture, governance and management that come with most sales. Likewise, many shareholders desire to liquidate only a portion of their equity and remain active in the company's business—a structure that is difficult to achieve with a third-party investor. Although the company can redeem a portion of a shareholder's stock, it must do so with after-tax funds. As a result, depending on the circumstances, an ESOP is worthy of consideration as an alternative to a sale or redemption.

Why Krieg DeVault?

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Krieg DeVault is, and has been for many years, a leader in the national ESOP community. Our attorneys:

- Were integrally involved in writing the S corporation ESOP enabling legislation and were directly involved in drafting the S corporation “anti-abuse” legislation.
- Hold leadership positions in the ESOP Association at the national and state chapter levels.
- Were co-founders and served on the Advisory Board of Employee-Owned S Corporations of America (ESCA).
- Speak on ESOP issues at substantially all national-level conferences sponsored by the National Center for Employee Ownership (NCEO) and The ESOP Association.
- Regularly speak on ESOP topics for national level trade associations.
- Publish articles in scholarly journals, such as the NCEO Journal of Employee Ownership Law and Finance and The Banking Law Journal, as well as trade publications.
- Host “Benefits in Brief” and ESOP conferences for clients at which current ESOP issues are discussed.
- Represent ESOP companies and trustees throughout the United States.
- Advocate and utilize “best practices” in all areas of the ESOP practice.
- Bring to bear partners and highly experienced associates to provide services at economical rates; our overhead is based on Indianapolis area costs.
- Approximately 60% of our ESOP Practice is based on “takeovers” of existing ESOPs, which have been the source of difficulty for the ESOP sponsor in one or more of the following areas
 - * Stock valuation
 - * Record keeping or plan administration
 - * Improperly or poorly structured ESOP transactions
 - * Unintentional fiduciary violations

In these cases, we correct the errors, make remedial filings with the IRS and Department of Labor, as applicable, and attempt to recoup the cost of corrections from the responsible service provider(s).

Deal Experience with Regulated Industries

Krieg DeVault’s ESOP attorneys have extensive and unique experience with regulated industries, including financial institutions, insurance companies, accounting firms, architectural and engineering firms and health care firms. In fact, our group has structured the following “firsts” in the area of ESOPs sponsored by regulated employers:

First ESOP to be Recognized as a Registered Bank Holding Company

In 1985, we structured the Horizon Bancorp ESOP. In this transaction, the Board of Governors of the Federal Reserve system approved, for the first time, an ESOP’s acquisition of more than 25

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percent of the outstanding stock of a bank holding company. This required, in turn, the approval of the ESOP's application to become a "registered bank holding company." The transaction involved 17 shareholders selling an aggregate of 31 percent of Horizon Bancorp's outstanding stock to the ESOP in a leveraged transaction which qualified for tax deferral under Section 1042 of the Internal Revenue Code.

First Accounting Firm to be Owned by an ESOP

In 2001, we structured the repurchase, from H&R Block, using solely the employer's qualified plan assets (based on participants' elections), of 100 percent of the stock of a large regional accounting and consulting firm. The structure involved the organization, due to state licensure laws, of a new accounting partnership and a management/consulting company; the latter corporation is the ESOP sponsor. At a meeting with the Treasury to discuss the transaction, the Treasury representative described the structure as ". . . a poster child for how to structure an S corporation ESOP management company."

First Optometry Firm to be Owned by an ESOP

In 2002, we structured the first ESOP to be sponsored by an optometry firm, the largest optometry practice in the Rocky Mountain Area. The transaction was structured in a manner which was similar to the structure developed for the accounting firm.

Financial Institutions ESOPs

The Practice Group has structured numerous leveraged and non-leveraged ESOP transactions for financial institutions subject to regulation by federal and state agencies, including tender offers, a "floor-offset" arrangement where the ESOP is the "offset" plan, acquisitions requiring prior approval of the Federal Reserve under the Bank Holding Company Act or prior notice under the Change in Bank Control Act, ESOP "spin-offs" and "dividend switchback" arrangements coupled with dividend pass-through or reinvestment features.

Indiana ESOP Initiative

In 2008, we closed the first ESOP transaction to be financed using the "Linked-Deposit Program" sponsored by the Office of the Indiana State Treasurer. Sharon Hearn and Steve Smith served on the Treasurer's ESOP Advisory Committee.

Our S Corporation ESOP Practice and Liberty Enterprises

In 1996, we were selected, through a process in which we competed with nationally-recognized ESOP practitioners, to structure an ESOP for Liberty Enterprises — which was an S corporation. At the time we were retained, we advised Liberty the law did not allow S corporations to sponsor ESOPs. Liberty engaged us to change the law to enable it to implement an ESOP. Our ESOP Practice, together with a Washington, D.C.-based lobbying firm, wrote the legislation necessary for S corporations to sponsor ESOPs. In the wake of the enabling legislation, we were also directly involved in the formation of Employee-Owned S Corporations of America ("ESCA") — a lobbying group consisting of S corporation ESOP sponsors and their service providers. As a member of ESCA's Advisory Board, Steve Smith was directly involved in drafting the 2001 "anti-abuse"

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legislation that became new Section 409(p) of the Internal Revenue Code.

Deal Experience

As noted above, our ESOP attorneys have participated in hundreds of ESOP transactions throughout the United States. The majority of those transactions involve middle market companies. Industries represented include manufacturing, insurance, retail, commodities brokerage, wholesale, transportation, privately owned utilities, custom machinery design and manufacturing, biotechnical, equipment leasing, forestry products, commercial and residential construction, architecture and engineering, health care, accounting, distribution and consulting and other professional services. In substantially all cases, we have been responsible for structuring the transaction.

Our Approach to Deals

In most transactions, we are not the “regular” counsel to the ESOP sponsor. Rather, we are retained as special ESOP counsel to the plan sponsor or counsel to the ESOP trustee. In all cases, we are sensitive to the historical role of corporate counsel and make every effort to approach transactions on a “team-oriented” basis with the objective of all service providers working as a team to achieve a common objective. In most transactions, we act as “quarterback.” In this role, we hold regular “all hands” telephone conferences based on an “actions and timelines” document with a view towards insuring that all service providers are on task and complete their work on a timely basis. However, we are pleased to perform services as a team member in cases where another service provider acts as quarterback.

Nature of Transactions

The size of our ESOP transactions ranges from \$1.5M to \$1.7 Billion.

In addition to the first-of-their-kind transactions described above, we have structured the following types of transactions:

- Leveraged acquisitions, by ESOPs sponsored by public and private companies, of blocks of stock owned by venture capital firms, including Citigroup and Norwest Equity Partners.
- Use of existing qualified plan assets (such as 401(k) plan accounts) to purchase employer securities, based on employee investment directions to ESOP trustees, with “price protection.” These transactions involve the preparation of offering-type disclosure documents for employees.
- Use of dividend-payable convertible preferred and “super common” stock where cash dividends are needed to enable an ESOP to pay its debt.
- Formation of holding companies to serve as plan sponsor for multiple businesses.
- Use of subordinated seller notes, and warrants to facilitate “seller financing.”

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- Spin-offs and split-ups of corporations followed by leveraged ESOP acquisitions of the “new” or “old” corporations.
- Development of strategies for addressing the ESOP repurchase obligation, including “re-leveraging” and “repurchase loans.”
- Mergers of multiple plans, followed by leveraged ESOP transactions.
- “ESOP II” transactions with “price protection” for “ESOP I” shares.
- “Rebalancing” and “reshuffling” of company stock accounts.
- “Unitization” of company stock and “liquidity” funds.
- Use of ESOPs as acquisition vehicles.
- Multi-investor leveraged ESOP transactions, including management and/or equity partner transactions involving financial fairness issues associated with the allocation of equity.
- Sales of ESOP companies to public and private companies and to “private equity” firms.
- Equity-based management incentive plans.
- Multi-seller Section 1042 transactions.
- Use of ESOP “prefunds.”
- Termination of leveraged and non-leveraged ESOPs.

We believe the principal reason our ESOP Practice has grown and prospered is the level of our initial and ongoing client support. We strive to visit each ESOP client at least annually and, for many of them, host an annual “ESOP Summit.” Our ESOP Summits are attended by all service providers (trustee, financial advisor, corporate counsel, accountants and lender). All relevant ESOP matters as well as the company’s business are addressed.

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